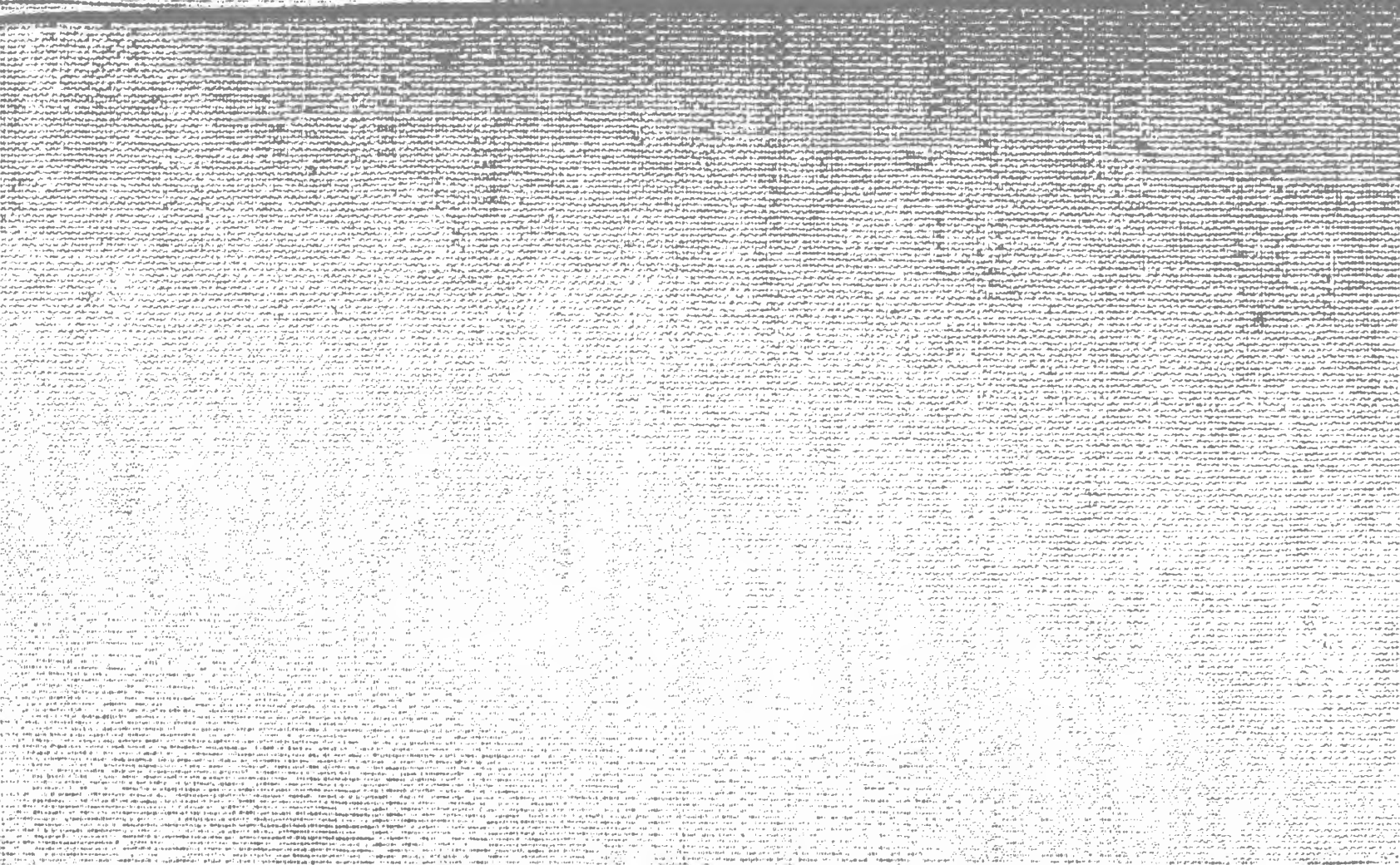

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No. 15799

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CLAIR DANIEL PITTS, JR.,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE.

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No. 15799

IN THE

United States Court of Appeals

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CLAIR DANIEL PITTS, JR.,

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Appellee.

BRIEF OF APPELLEE.

I.

Jurisdictional Statement.

This is an appeal from a verdict of the United States District Court for the Southern District of California, which found the appellant to be guilty of Count Two of a two-count indictment (see Statement of Case, below), which indictment was brought under the provisions of Section 1001 of Title 18, United States Code.

The violations are alleged to have occurred in Los Angeles County, California, within the Central Division of the Southern District of California.

The jurisdiction of the District Court is based upon Section 3231 of Title 18, United States Code. This court has jurisdiction to entertain this appeal and to review the proceedings leading to said verdict by reason of the provisions of Sections 1291 and 1294 of Title 28, United States Code.

II.
Statement of the Case.

An indictment in two counts was filed on January 9, 1957, charging the appellant essentially as follows:

Count One: On or about December 22, 1954, the appellant knowingly and wilfully made false and fraudulent statements and representations in a matter within the jurisdiction of the Department of Defense upon a Personnel Security Questionnaire, to the effect that he had received an Honorable Discharge from the United States Air Force; that he had never been arrested, charged or convicted of any criminal offense except traffic violations; that he had previously been granted a security clearance with the Atomic Energy Commission to the level of secret.

Count Two: On or about October 24, 1955, the appellant knowingly and wilfully made false and fraudulent statements and representations in a matter within the jurisdiction of the Atomic Energy Commission upon a Personnel Security Questionnaire, to the effect that he had never been arrested, charged or convicted of any criminal offense except traffic violations; that he had never been refused clearance by any branch of the Federal Government.

The case was tried by the Honorable William C. Mathes without a jury and commenced on April 25, 1957. The Court returned its verdict on May 16, 1957, wherein it was found that the appellant was acquitted on Count One and found guilty as charged on Count Two.

Judgment was entered on June 3, 1957.

Notice of Appeal was filed on June 7, 1957.

III.
Statement of the Facts.

On December 20, 1954, the appellant Clair Daniel Pitts, Jr., was hired as a Junior Physicist with Litton Industries in Los Angeles, California, under the name of Jack Lang.

It is the general practice of Litton Industries to have the employee fill out an original Personnel Security Questionnaire (PSQ) at the time of employment or hiring. When the company desires that he be cleared for access to classified information, the employee's department head notifies the security director and gives the information or need for his clearance. The original PSQ is pulled out of the employee's personnel folder, typed, and presented to the employee for his thorough examination so that errors or omissions may be corrected. After this is done the employee signs the PSQ, and it is witnessed by an employee of the security department [R.* 95, 96]. It is then forwarded by the company to the proper government agency.

The company was generally interested in government contracts of a classified nature [R. 110]. Before a company could be awarded such a contract, it had to have sufficient technical personnel cleared for security or be willing to clear them [R. 110]. Thus, Litton Company attempted to clear its technical personnel as soon as possible after their joining the company. It had a uniform practice with respect to clearing employees of the junior physicist level [R. 109].

During the year 1955, Mr. Harry Jack Gray served as General Manager of the Components Division and Nuclear

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*Reporter's Transcript.

Electronics Division [R. 104]. He had negotiations with certain government agencies, among them the Atomic Energy Commission [R. 112]. The subject matter of these negotiations involved work of a classified nature [R. 113]. Litton Industries used classified information in some of their projects [R. 108, 109]. During the year 1955, the company was engaged in secret or confidential matters for the Department of Defense [R. 155].

In 1955 Litton Industries applied for an access permit from the Atomic Energy Commission [R. 113]. Such a permit was issued in August, 1955 [R. 114, Ex. 4]. This permit would authorize the company to receive classified information and it was anticipated that classified information to the level of confidential would be released to the company [R. 116, 117]. The company requested that certain additional personnel be passed upon for security clearance so that they could have access to this material. Among these persons was the appellant, known then as Jack Lang [R. 117]. The appellant's status as a "key employee" had been determined by Mr. Harry Jack Gray, Mr. Lang's division head, in the spring of 1955 [R. 111].

When the appellant joined the company in December, 1954, he was hired as a junior physicist. In this capacity it was contemplated that he would assume some of the duties of the senior physicist by engaging in reactor technology work as set forth in the "Application for Access to Information on Nuclear Reactor Technology." The employment category of Senior Physicist was one of the categories specifically included in the application for the

Access Permit and one that would have access to classified information under the permit [R. 125, 126, Ex. 5].

Some of the actual duties performed by the appellant while at Litton Industries were:

> "He was involved in several projects designed to develop an optimum configuration for thulium isotopes, the incapsulation of those isotopes, the performance of loading and unloading radioactive thulium capsules, the measurement of the radiation from these capsules, the taking and development of radiographs, the inspection and radiographing of materials submitted to us by interested parties and various other things" [R. 148].

Prior to making application for the Access Permit, the company promoted the appellant to an intermediate physicist. It was contemplated that he may be promoted to senior physicist [R. 163, 166].

On correspondence and pamphlets prepared by the appellant, while engaged in his duties at Litton Industries, he represented himself to be a physicist and so signed these documents [Exs. B, F-1, F-2, H, I].

In October, 1955, a PSQ under the heading of Atomic Energy Commission was filled out and certified to by the appellant Jack Lang, and submitted to the AEC [R. 175, Ex. 6]. At no time was a clearance of any type issued by the AEC for the appellant [R. 179].

At the time of his executing the PSQ on October 24, 1955, the appellant also executed a document called a Security Acknowledgment, which set forth certain re-

sponsibilities of the applicant in regards to classified information [R. 185, 198, 199, Ex. 7].

After the PSQ was forwarded to an office of the AEC, it was screened by AEC personnel to verify the applicant's position and the need for the clearance [R. 181, 182, 188]. A representative of the AEC was at Litton Industries and was shown by the appellant what his duties were regarding radioactive isotopes [R. 190].

The appellant, to question No. 24 of the PSQ to Atomic Energy Commission, Exhibit 6, answered in the negative, indicating that he had never been arrested, charged, or convicted of any criminal offense except certain traffic violations.

The appellant had in fact been convicted on three prior occasions in the Parish of Orleans, Louisiana [R. 200, Exs. 3, 3-A, 3-B].

In May, 1955, the appellant wrote a letter to the Air Adjutant General, United States Air Force, requesting a review of his undesirable discharge. In this letter, he pointed out the fact that he was working as a physicist for Litton Industries and that application was being made for his security clearance through the AEC [R. 318, 319, Ex. 12]. In this letter, he further claimed to be a physicist at Litton Industries and an Associate Professor of Physics at Fremont College [R. 319].

IV.
ARGUMENT.

Introduction.

Since the appellant was acquitted on Count One and convicted on Count Two, only Count Two will be discussed and no reference will be made to any facts surrounding Count One except as may be pertinent to Count Two.

Conflicts of Fact and Credibility of Witnesses Are to Be Decided by the Trial Court.

It is well settled that an appellate court will not review questions of fact nor weigh evidence where there is any substantial and competent evidence to support a finding of guilt. On review the appellate court will consider the evidence and all the inferences which may reasonably be drawn therefrom from the aspect most favorable to supporting the findings of the court below.

Woodward Laboratories Inc., et al. v. United States, 198 F. 2d 995, 998 (9th Cir., 1952);

Pasadena Research Laboratories v. United States, 169 F. 2d 375, 380 (9th Cir., 1948), cert. den. 335 U. S. 853.

And the foregoing is equally applicable to a trial by the court without a jury.

Penosi v. United States, 206 F. 2d 529, 530 (9th Cir., 1953);

C-O-TWO Fire Equipment Co. v. United States, 197 F. 2d 489, 491 (9th Cir., 1952), cert. den. 344 U. S. 892;

United States v. Empire Packing Company, 174 F. 2d 16 (7th Cir., 1949), cert. den. 337 U. S. 959.

It is submitted that the first three elements of the crime alleged in the indictments—as set forth in the Argument herein—are questions of fact. The appellant has not challenged the sufficiency of the evidence to support the conviction and since there was evidence to support the trial court's decision as to these three points, the appellate court should review those findings from the aspect most favorable to the appellee.

It should be pointed out that the appellant has based many of his arguments and points upon the evidence which is most favorable to him, notwithstanding evidence to the contrary contained in the record and from which the court could have based its conviction.

Elements of the Offense.

In the case of *United States v. Dietrich* (C. C., D. Neb., 8th, 1904), 126 Fed. 676, 685, cited in the appellant's brief, it was held that "In prosecution for criminal offense, the act charged must have possessed, at the time when its commission was complete, every element necessary to its criminality."

Looking then to the particular Statute under which the indictment was brought, we must first determine the elements of this offense. If these elements are all present then the conviction must be affirmed. Under Section 1001, Title 18, United States Code, there are four elements.

A. That a False Statement or Representation Was Made.

In the PSQ submitted to the Atomic Energy Commission by the appellant [Ex. 6], in response to question number 24, asking whether the applicant had ever been arrested, indicted, summoned or convicted in a criminal proceeding, the appellant answered "No." This was in-

itialed by the appellant and the entire document was certified to by him on October 24, 1955. The execution was witnessed by an employee of Litton Industries, Gertrude Lynch, of the Security Department [Ex. 6].

The appellant had in fact been convicted on three prior occasions. Two of these convictions were for single counts of forgery. The third conviction was in two counts; one, for false impersonation of a doctor of medicine; second, for performing acts of a doctor of medicine in a hospital while falsely assuming the character of a doctor of medicine.

B. That Such Statement or Representation Was Made Knowingly and Wilfully.

The events concealed by the appellant's answer to question 24 of the PSQ to the AEC were acts within his past conduct, and in the absence of some showing that the appellant lacked the mental ability to recall them, it must be assumed to have been done knowingly.

On the occasion of his filling out the PSQ on October 24, 1955, he was asked specifically if this was his answer to which he certified that it was by placing his initials by this and other answers [Ex. 6].

On May 17, 1955, a letter was received by the Air Adjutant General of the United States Air Force from the appellant. In this letter he stated that application was being made for him with the AEC for an "L" security clearance [Ex. 12].

On two prior occasions, the appellant had filled out PSQs, so this was not a new experience to him. In 1950 when applying for security clearance while in the United States Air Force, the appellant executed a PSQ. On De-

cember 22, 1954, he executed a form DD-48, PSQ for the Department of Defense, the subject matter of Count One.

Having had this experience, the appellant should have known at a glance what kind of document he was executing and the effect of such an application. As evidenced by the letter to the Air Adjutant General [Ex. 12], he was fully aware of his status as an applicant for security clearance with the AEC. In his letter to the Air Adjutant General, Mr. Lang seemed to use this fact as a compliment to himself attempting to show that anyone who is being considered for such clearance is worthy of a review of his undesirable discharge.

He further represented to the Air Force in this letter that he was employed at Litton Industries as a physicist. This was not qualified by the term "junior" or "intermediate," which was actually his title, but this qualifying term was omitted. This appears to have been done either believing himself capable of performing the work of a physicist or done with intent to mislead the Air Force as to his true position. Certainly he believed himself capable of being a physicist because he represented himself to be employed at Fremont College as an Associate Professor of Physics.

The motive for so concealing these facts is that Mr. Lang had found a good position and he feared exposure which probably would have resulted in his not being cleared or a change in position. The least that can be said is that the false statements were made with knowledge and made wilfully.

C. That the Statement Was Made in a Matter Within the Jurisdiction of an Agency or Department of the United States.

What is the "matter" here which purportedly comes within the jurisdiction of the United States? As pertains to this particular individual, the statement was made on an application for a security clearance with the Atomic Energy Commission. In essence, the appellant desired access to classified information relating to atomic energy. The matter then which is being controlled is classified information on atomic energy. Is this a matter within the jurisdiction of a department or agency of the United States?

In *United States v. White* (D. C. Cal., 1946), 69 Fed. Supp. 562, it was held that "jurisdiction" is synonymous with "power to act." Does the United States have power to act in this matter?

In *United States v. Gilliland* (1941), 312 U. S. 86, 61 S. Ct. 518, 85 L. Ed. 598, the Supreme Court said that the purpose of this statute, 18 United States Code, Section 1001, is to protect the authorized functions of governmental agencies and department from the perversion which might result from the deceptive practices described.

United States v. Friedus (1955), 223 F. 2d 598, 96 U. S. App. D. C. 133;

United States v. Myers (D. C. Cal., 1955), 131 Fed. Supp. 525;

United States v. Stark (D. C. Md., 1955), 131 Fed. Supp. 190.

Is this an authorized function of government or of any agency or department to control information on atomic energy and specifically that which is known as Restricted

Data? Following are statutes which authorize the Atomic Energy Commission to act in this field:

Section 2201(b) of Title 42, United States Code, gives the Commission authority to establish by rule or regulation the use and possession of nuclear material.

Section 2201(i) authorizes the Commission to provide regulations to protect Restricted Data, protect the security of the program, and national defense, and protect public health and property.

Section 2201(q) authorizes the Commission to pass regulations necessary to carry into effect purposes of the program.

10 CFR Sections 25.11 *et seq.,* govern in part the use of classified material of the Commission.

Section 25.11 provides for an application for an Access Permit and sets forth information that must be furnished by the permitee.

Section 25.22 provides all Access Permits will authorize use of Restricted Data, subject to personnel security clearances.

Section 95.31 requires that no person (here the permitee, Litton Industries) who possesses classified material shall distribute such material to personnel not cleared to proper level.

Here, the company had applied for [Ex. 5], and had been granted an Access Permit [Ex. 4], which permit was issued on August 15, 1955. The appellant executed his application for security clearance, the PSQ to the AEC, on October 24, 1955, after the company had been granted authority to receive restricted data under the Access Permit.

Atomic energy is an area of vast importance to the well-being of the United States. Since the dissemination of this information to individuals incapable of keeping the information secure could result in great harm to the United States, it is necessary to place safeguards around such information.

Its value is not limited to military purposes. The law of physics knows no distinction between military and civilian uses. Its operation is the same under either classification. Still the protection of the information is vital regardless of designation. Thus, atomic energy information may be "classified" in both defense and non-defense projects.

Even though the actual or contemplated duties of the appellant while at Litton Industries were basically of a civilian or non-defense nature as seen above, this does not mean that within this area there can be no classified information.

This is evidenced by the application of Litton Industries for access to non-military restricted data [Ex. 5, Document entitled Agreement and Waiver].

Further, on page 2 of the Application for the Access Permit at paragraph 7(a) under the heading, "7. Specific Undertakings which the applicant (Litton Industries) wishes to pursue under this agreement . . . (b) Study of physical properties and availability of radio isotopes suitable for radiography." As set forth in the Statement of Facts above, the appellant's duties bear the same description in part as does the contemplated activities of the company under sub-paragraph (b) above.

The appellant contends that since he was only interested in the health aspects of physics; that his duties did not

include work on classified information; that the work he was performing did not require him to have access to classified information, he does not therefore come within the jurisdiction of any government agency.

Such an argument is unrealistic and misinterprets the meaning of the statute. The statute does not read, "whoever, within the jurisdiction of . . ." but it reads, "whoever, in a *matter* within the jurisdiction of . . ." (Emphasis added.) The term jurisdiction applies to and qualifies the word "matter" and not "whoever."

If the agency or department has jurisdiction or power to act in the matter or function in question, it is not necessary to show that the person charged stands in the same relationship to the government as does the matter or function. The thing sought to be controlled is the Restricted Data, not CLAIR DANIEL PITTS, JR., or Jack Lang.

The case of *United States v. Moore* (C. A., Fla., 1950), 185 F. 2d 92, cites the basic proposition that this statute is to be construed within the fair meaning of its terms. Its terms as pointed out above are that the term "jurisdiction" applies to and qualifies "matter."

The appellant points out (in his brief) that his duties did not require access to restricted data. He justifies this by saying that he did not receive any restricted data while at Litton Industries. The appellant is attempting to determine whether or not he should have been applying for a security clearance. He is attempting to judge his abilities in relation to the contemplated activities of the company.

How could the appellant know whether he could or could not perform any work of a restricted nature? Restricted is not synonymous with complicated. Further, the appellant had no knowledge of the contents of the access permit,

the negotiations with the AEC, the work necessary under the negotiations or of the contemplated contracts. This is assumed because of the restricted nature of these things. This is believed to be true even though the appellant had an understanding that he would be working on classified projects [Ex. 12].

In order to determine how many employees of which particular employment categories will be required to fulfill any contemplated contract, the company must first have preliminary negotiations with the AEC. These negotiations took place between the AEC and the company [R. 112, 113]. The company and the AEC were the only ones aware of what it would require in the way of manpower to do the contemplated work. The justification that the appellant asserts that he never worked on restricted data is no explanation at all. The testimony at trial showed that the appellant had never been granted a clearance of any kind [R. 179]. Section 25.22 of 10 CFR requires that no one can disseminate restricted data to uncleared persons. Since the appellant had not been cleared, he could not receive restricted data.

Thus, the company, which was in a position to know the requirements of atomic energy contracts was the proper one to determine who should be processed for clearance. In effect, the appellant and the company are requesting clearance so that the appellant may have access to classified information, after it is received by the company under either the access permit or a contract with the AEC.

Does the statute only apply to those who are required by some statute or regulation to make the statement?

This is a primary contention of the appellant, but the appellee believes it is not supported by case law or the

regulations. According to the Atomic Energy Commission Manual, Section 2302-03, the following definition is set forth:

> "AEC security clearance is an authorization which permits an individual to have access to Restricted Data and other classified matter as may be required in the performance of his duties involved with employment or assignment." (Cited in App. Br. p. 41.)

The appellee's interpretation of this regulation is as follows: Taken in the order of the appearance of the words, the security clearance comes first, a requirement which must be met before anyone can receive any classified material. The language of this regulation does not state that before a clearance is granted, the employee must be shown to require the material in his assignment. If this were the case, a clearance would have to be made each time an assignment required an employee to have access to such material. Rather, the clearance is a preliminary blanket approval of the individual's character, fitness, background and his trustworthiness. This clearance in itself is not authorization for specific data. To receive particular documents, charts, blueprints, etc., an employee must then show to the person charged with control of such documents that his particular assignment requires that he have access to this particular document, etc. The regulation described above setting forth such a "need to know" is not a condition precedent to the granting of the clearance, but is a condition precedent to the giving of *particular* classified information. If this were not the case, then every person cleared to the level of Confidential for example, would have a right to examine every confidential document wherever found or used in any project by any contractor whatsoever.

Such a situation would be most impractical and would not aid in the control of restricted data, which is one purpose of these regulations. Even though an individual is cleared, this is no guarantee that he will uphold his trust. So, to minimize the danger of possible unauthorized dissemination, this regulation permits that only such classified material be given to an individual as may be shown to be required by his assignment.

The cases decided under this statute do not hold that the statement be required under some statute or regulation. In the case of *United States v. Cohen* (1953), 201 F. 2d 383 (C. A. 9), this court said that Section 1001 of Title 18, United States Code, is not limited to statements which are required to be made by some law or regulation, and therefore, the giving of false statements voluntarily to Agents of the Treasury Department regarding declarant's financial affairs, was a violation of this section. (See also, *United States v. Meyer* (1944), 140 F. 2d 652 (C. A. 2), where declarant could have declined to answer questions at an exclusion hearing, however, chose to answer voluntarily, but lied. The question of requirement to answer was not considered by the court.)

Here, the appellant was under no compulsion to submit the PSQ to the AEC, but did so and included therein a false statement. He could have refused to submit one, but once he did, he then came within the provisions of the statute in that he must answer truthfully or suffer the legal consequences.

Finally, since the statutes and regulations mentioned above grant authority to the Commission to have jurisdiction over the dissemination of restricted data as relates to atomic energy, the matter within such jurisdiction of the AEC as pertains to the appellant is the power to act

or decide on whether or not he shall be granted a security clearance, which clearance if granted, would entitle him to have access to restricted data on atomic energy.

One of the factors to be considered in deciding this question was the criminal background, if any, of the applicant, Mr. Lang. This brings us to the last issue here raised.

D. That the Statement Made, Falsified, Concealed or Covered Up a Material Fact.

In *Ebeling v. United States,* 248 F. 2d 429 (8th Cir., 1957), where the defendant was indicted under Title 18, United States Code, Section 1001 for making false statements, the court pointed out that it is a violation of Section 1001 for anyone wilfully to make or use a false writing or document knowing it to be false and intending that it shall bear a relation or purpose as to some matter which is within the jurisdiction of a department or agency of the United States, and with the false statement which it contains having a materiality on the department or agency matter.

It has been judicially determined that the question of relevancy is not open to one who knowingly makes false statements with intent to mislead the government. This was the holding in *United States v. Eisler,* 75 Fed. Supp. 634 (D. C., D. C., 1947), where the defendant made false statements in an application for permission to leave the United States.

Assuming for purposes of argument that the District Court in the *Eisler* case was incorrect and that the ques-

tion of materiality and relevancy is still open to one who knowingly makes false statements with intent to mislead the government, it is submitted that information as to prior criminal activities is of utmost importance in respect to the position of trust and confidence which a person working in sensitive areas occupies. Atomic energy information is an important factor to the maintenance of the economy, progress, security and independence of the United States. If the United States is to maintain these blessings, it is imperative that such vital information be kept out of hostile hands. The purpose of the security plan is to screen those persons who might come into contact with this vital information so that only those who are trustworthy are permitted access to it.

The government is not trying to equate prior criminal activity with leakage of vital information. However, prior criminal activities have a bearing on ones social conduct. It is some evidence of character and fitness. As pointed out in *United States v. De Lorenzo,* 151 F. 2d 122 (C. C. A. N. Y., 1945), where the defendant made false statements about prior criminal activities and employment on an application for Federal employment, the court held:

> "It cannot be said that the questions asked were irrelevant. Those in both 37 (*re:* prior employment) and 15 (prior criminal activities) bore on his social conduct and on his qualifications. The objection to the jurisdiction of the Civil Service Commission to make such inquiries seems to us wholly unsubstantial."

In *United States v. Marzani,* 71 Fed. Supp. 615 (D. C. D. C., 1947), the court ruled as a matter of law that ques-

tions concerning communist activities and use of false names were pertinent, relevant, and material in evidencing the defendant's character and fitness, for they had a direct bearing thereon. In the words of the court it was stated:

> "In view of the authority of the agencies involved (*i.e.,* F. B. I.; Civil Service Commission; Department of State), the court holds as a matter of law that the questions propounded of defendant were pertinent, relevant, material, and well within the scope of the investigation as to the defendant's character and fitness, for they had a direct bearing thereon. This is doubly true in time of war, and particularly in view of the character of the agencies involved and the nature of the work with which they were charged."

The court went on to say that if falsehoods are imposed upon persons charged with the duty of ascertaining these qualifications and made to take the place of facts, then the United States is defrauded.

The reasoning set forth in the *Marzani* case above well applies to this case. At the time the PSQ in question was executed this country was engaged in a nuclear achievement battle with certain aggressive nations. Today, the battle still goes on. Atomic energy is important to this country for many reasons. First and foremost is its use as a potential defense to this country against aggression. In this day of continual unrest among the nations of the world, where armed aggression may take place at any time, the effectiveness of atomic energy as a defense would be greatly reduced should the laws of its operation be disclosed to a future aggressor. Atomic energy information to the United States is like a trade secret is to a corporation

in private competition. As long as the information remains secret, the corporation holds a commanding advantage over its competitors. But as soon as the secret is no longer secret, the advantage is lost. Losing any advantage we now possess or shall possess could be disastrous to this nation.

The importance of this work is demonstrated by the agencies which were concerned and involved in this particular case: the Federal Bureau of Investigation, the Civil Service Commission and the Atomic Energy Commission. These are the agencies charged with the responsibilities of preserving and protecting this information.

In *United States v. Giarraputo,* 140 Fed. Supp. 831 (D. C. N. Y., 1956), which factually is very similar to the case at bar, the defendant was employed in a sensitive area. On a Department of Defense PSQ he falsely denied any prior criminal activity. The court in pointing out the necessity of rigid requirements as to the character and integrity of persons who come into contact with sensitive material stated:

> "There is no doubt as to the materiality of the falsification here charged."

The relationship between allowing only people of good moral character access to classified materials and the preservation of security is obvious. Persons in sensitive positions must be free from external pressures of possible blackmail or pressure groups, so that no influence can make him divulge information contrary to the security of the United States.

V.
Conclusion.

It is submitted that the trial court committed no error as pertains to Count Two of the indictment; that all of the essential elements of the crime therein charged were sustained by the evidence; that there was sufficient evidence upon which the court could base its verdict; and that therefore, the judgment of the trial court should be affirmed.

Respectfully submitted,

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No. 15804

United States
Court of Appeals
for the Ninth Circuit

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Appellants,

vs.

HOME SAVINGS & LOAN ASSOCIATION, a Corporation,

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Transcript of Record

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Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—1-10-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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139 North Broadway,
Los Angeles 12, California.

In the United States District Court, Southern District of California, Central Division

No. 548-57 Y

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Plaintiffs,

vs.

HOME SAVINGS & LOAN ASSOCIATION, a Corporation, and HOWARD F. AHMANSON,

Defendants.

COMPLAINT

(Damages—Breach of Contract)

Plaintiffs complaint of Defendants and allege:

I.

That Plaintiff, Mortgage Services of Norfolk, Inc., is a corporation incorporated under the Laws of the State of Virginia, and maintains its principal place of business within the City of Norfolk, State of Virginia, and now is and at all times mentioned herein has been a citizen and resident of the State of Virginia, and a nonresident of the State of California. That, at all times mentioned herein, the Plaintiff, Warren A. Ott, is a citizen of the State of Virginia, and resides in the City of Norfolk, State of Virginia, and is not a resident or citizen of the State of California.

II.

That the Defendant, Home Savings & Loan Association, at all [2*] times mentioned herein, was and is a corporation organized and existing under the Laws of the State of California, and maintains its principal place of business within the City of Los Angeles, State of California, and is a citizen and resident of the State of California, and within the Southern District, Central Division of this Court.

III.

That the Defendant, Howard F. Ahmanson, at all times mentioned herein, has been and now is a resident and citizen of the State of Califorina, and a resident within the Southern District, Central Division of the above-entitled Court.

IV.

That the matter in controversy, exclusive of interests and costs, exceeds $3,000.00.

V.

That the jurisdiction of this Court is conferred by provisions of Title 28, United States Code, Section 1332.

VI.

That, on or about the 31st day of December, 1953, the Defendants, and each of them, made and executed an agreement in writing, by the terms of which said agreement the Defendant, Home Savings & Loan Association, a corporation, by and through the Defendant, Howard F. Ahmanson, acting as its President, promised and agreed to purchase from

*Page numbering appearing at foot of page of original Certified Transcript of Record.

one Harold L. Shaw, or his nominee, within three (3) years from date thereof, up to Seven Million Five Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans to be guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as Amended. Said agreement in writing further provided that the said loans shall have a maturity date of twenty-nine (29) years, and that the purchase price of the said loans was to be at par less seven and one-half (7½%) per cent thereof.

VII.

That, on or about the 10th day of November, 1956, the said Harold L. Shaw, by an instrument in writing, designated and appointed the [3] Plaintiffs herein as his nominee under and pursuant to the aforesaid agreement in writing, and did by an instrument in writing assign, set over, transfer and convey unto Mortgage Services of Norfolk, Inc., and Warren A. Ott all of his right, title and interest and all of his rights in and to the aforesaid agreement in writing with the Defendants, as aforesaid, and that at all times since the said 10th day of November, 1956, the Plaintiffs have been and are the owners and holders of all of the right, title and interest of the said Harold L. Shaw in and to the agreement in writing hereinabove set forth.

VIII.

That, on or about the 20th day of December, 1956, and within three (3) years from date of execution of the aforesaid agreement in writing, the Plaintiffs

tendered to the Defendants, and each of them, and offered to sell and deliver to the Defendants, and each of them, at par less seven and one-half (7½%) per cent thereof, pursuant to the aforesaid agreement in writing, Seven Million Five Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as Amended.

IX.

That the Plaintiffs herein fully performed all of the terms and conditions of the aforesaid agreement in writing. That the Defendants, and each of them, in breach of the agreement, as aforesaid, failed and refused to purchase from the Plaintiffs the said Seven Million Five Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans, or any part thereof, and have, at all times since the said 20th day of December, 1956, continued to fail and refuse to purchase the said real estate loans from the Plaintiffs herein.

X.

That, as a direct and proximate result of the acts of the Defendants, and each of them, as aforesaid, the Plaintiffs herein have been damaged in the sum of $237,135.80.

Wherefore, Plaintiffs pray: [4]

1. For judgment against the Defendants, and each of them, in the sum of $237,135.80, together with interest from date of filing of this action.

2. For costs of suit.

3. For such other and further relief as to the Court may seem meet and just in the premises.

HINDIN and SUSMAN, and
EDWIN J. REGAN,

By /s/ MAURICE J. HINDIN,
Attorneys for Plaintiffs.

Duly verified.

[Endorsed]: Filed April 30, 1957. [5]

[Title of District Court and Cause.]

MINUTES OF THE COURT
September 9, 1957

Present: Hon. Leon R. Yankwich, District Judge;
Counsel for Plaintiff: Maurice Hindin, Esq.;
Counsel for Defendant: Paul Fitting, Esq.

Proceedings: Hearings.

(1) Defendant Howard F. Ahmanson's motion for summary judgment.

(2) Plaintiff's motion to strike 1st & 3rd affirmative defenses from answer.

(3) Defendant Home Savings' motion for summary judgment.

Attorney Hindin for plaintiff moves to amend complaint by interlineation. Court denies said motion but grants leave to file amended complaint.

Both sides argues various motions.

It Is Ordered that:

(1) Defendant Howard F. Ahmanson's motion for summary judgment be granted and that his attorney prepare findings and order.

(2) Plaintiff's motion to strike, etc., be denied.

(3) Defendant Home Savings' motion for summary judgment be denied.

JOHN A. CHILDRESS,
Clerk.

By /s/ L. CUNLIFFE,
Deputy Clerk. [7]

[Title of District Court and Cause.]

AMENDED COMPLAINT
(Damages—Breach of Contract)

Leave of Court having heretofore been granted Plaintiffs to file an Amended Complaint, Plaintiffs complain of the Defendant and allege:

I.

That Plaintiff, Mortgage Services of Norfolk, Inc., is a corporation incorporated under the Laws of the State of Virginia, and maintains its principal place of business within the City of Norfolk, State of Virginia, and now is and at all times mentioned herein has been a citizen and resident of the State of Virginia, and a nonresident of the State of Cali-

fornia. That, at all times mentioned herein, the Plaintiff, Warren A. Ott, is a citizen of the State of Virginia, and resides in the City of Norfolk, State of Virginia, and is not a resident or citizen of the State of California.

II.

That the Defendant, Home Savings & Loan Association, at all [8] times mentioned herein, was and is a corporation organized and existing under the Laws of the State of California, and maintains its principal place of business within the City of Los Angeles, State of California, and is a citizen and resident of the State of California, and within the Southern District, Central Division, of this Court.

III.

That the matter in controversy, exclusive of interests and costs, exceeds $3,000.00.

IV.

That, at all times mentioned herein, Howard F. Ahmanson was the duly elected, acting and qualified President of Defendant, Home Savings & Loan Association, and at all times herein acted within the scope of his employment and in the course of his employment as such President of the Defendant.

V.

That the jurisdiction of this Court is conferred by provisions of Title 28, United States Code, Section 1332.

VI.

That, on or about the 31st day of December, 1953, the Defendant, Home Savings & Loan Association, a corporation, acting by and through one Howard F. Ahmanson, its President, made and executed an agreement in writing, by the terms of which said agreement the said Defendant promised and agreed to purchase from one Harold L. Shaw, or his nominee, within three (3) years from date thereof, up to Seven Million Fixe Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans to be guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as Amended. Said agreement in writing further provided that the said loans shall have a maturity date of twenty-nine (29) years, and that the purchase price of the said loans was to be at par less seven and one-half (7½%) per cent thereof. A copy of said agreement is attached hereto and incorporated herein by reference thereto and is marked "Exhibit A." [9]

VII.

That, on or about the 10th day of November, 1956, the said Harold L. Shaw, by an instrument in writing, designated and appointed the Plaintiffs herein as his nominee under and pursuant to the aforesaid agreement in writing, and did by an instrument in writing assign, set over, transfer and convey unto Mortgage Services of Norfolk, Inc., and Warren A. Ott all of his right, title and interest and all of his rights in and to the aforesaid agreement in writing with the Defendant, as aforesaid,

and that at all times since the said 10th day of November, 1956, the Plaintiffs have been and are the owners and holders of all of the right, title and interest of the said Harold L. Shaw in and to the agreement in writing hereinabove set forth. A copy of the said instrument in writing is attached hereto and incorporated herein by reference thereto and marked "Exhibit B."

VIII.

That, on or about the 5th day of December, 1956, Plaintiffs herein notified the Defendant of their aforesaid nomination and assignment.

IX.

That, between the said 5th day of December, 1956, and the 8th day of January, 1957, the Defendant recognized, acknowledged and dealt with the Plaintiffs herein as the assignee of Harold L. Shaw, and in reliance thereon Plaintiffs herein changed their position to their detriment and damage as is hereinafter set forth.

X.

That, on or about the 20th day of December, 1956, and within three (3) years from date of execution of the aforesaid agreement in writing, the Plaintiffs tendered to the Defendant and offered to sell and deliver to the Defendant, at par less seven and one-half (7½%) per cent thereof, pursuant to the aforesaid agreement in writing, Seven Million Five Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans having a maturity date of twenty-nine (29) years and guaranteed

under the provisions of the Servicemen's Readjustment Act of 1944, as Amended. That on the same day Plaintiffs herein did deliver to the Defendant an instrument in writing, [10] a copy of which said instrument is attached hereto and is incorporated herein by reference thereto and is marked "Exhibit C."

XI.

That the Plaintiffs herein fully performed all of the terms and conditions of the aforesaid agreement in writing, dated December 31, 1953, a copy of which is attached hereto and incorporated herein by reference thereto and is marked "Exhibit A," and at all times mentioned herein they have been and were ready, able and willing to fully perform all the terms and conditions of the aforesaid agreement.

XII.

That the Defendant, in breach of the agreement, as aforesaid, failed and refused to purchase from the Plaintiffs the said Seven Million Five Hundred Thousand Dollars ($7,500,000.00) worth of permanent real estate loans, or any part thereof, and has, at all times since the said 20th day of December, 1956, continued to fail and refuse to purchase the said real estate loans from the Plaintiffs herein.

XIII.

That, as a direct and proximate result of the acts of the Defendant, as aforesaid, the Plaintiffs herein have been damaged in the sum of $237,135.80.

Wherefore, Plaintiffs pray:

1. For judgment against the Defendant in the sum of $237,135.80, together with interest from date of filing of this action.

2. For costs of suit.

3. For such other and further relief as to the Court may seem meet and just in the premises.

HINDIN AND SUSMAN, and
EDWIN J. REGAN,

By /s/ MAURICE J. HINDIN,
Attorneys for Plaintiffs. [11]

EXHIBIT A

Home Savings and Loan Association
Main Office: 800 South Spring Street,
Los Angeles 14, California, TRinity 7991

December 31, 1953.

Mr. Harold L. Shaw,
650 South Spring Street,
Los Angeles 14, California.

Dear Mr. Shaw:

This letter is to serve as a binding commitment, for a period of three years from date hereof, upon Home Savings and Loan Association to make to you or your nominee the following loans:

(1) Two and one-half million dollars ($2,500,000) in permanent real estate loans to be guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as Amended. Said loans shall have a maturity date of twenty-nine years and call for no down payment, and Home shall, not make any service charge therefor, but shall be entitled to the one per cent (1%) charge to be collected from the Veteran purchaser.

(2) In addition to the above, Home agrees to purchase from you or your nominee up to Seven and One-half Million Dollars ($7,500,000) of permanent real estate loans to be guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as Amended. Said loans shall have a maturity date of twenty-nine years. The purchase price of said loans to be at par less seven and one-half per cent (7½%) thereof.

Yours very truly,

HOME SAVINGS AND LOAN ASSOCIATION,

/s/ HOWARD F. AHMANSON,
President. [12]

EXHIBIT B

Designation of Nominee and Assignment of Commitment

For and Inconsideration of Ten ($10.00) Dollars and other good and valuable consideration, I, the undersigned Harold L. Shaw, herewith designate and appoint Mortgage Services of Norfolk, Inc., and Warren A. Ott, of Norfolk, Virginia, as my Nominee under that certain commitment executed December 31, 1953, by Home Savings & Loan Association, by Howard Ahmanson, President, to the undersigned, a copy of which said loan commitment is attached hereto.

I, the undersigned Harold L. Shaw, herewith assign, set over and transfer unto Mortgage Services of Norfolk, Inc., and Warren A. Ott, as my nominee, all of my right, title and interest in and to the aforesaid commitment and all of my rights thereunder.

Dated: 10th day of November, 1956.

/s/ HAROLD L. SHAW.

Foregoing Assignment Is Accepted:

Dated: November 15, 1956.

MORTGAGE SERVICES OF NORFOLK, INC.,

By /s/ WARREN A. OTT,
President.

/s/ WARREN A. OTT.

EXHIBIT C

Mortgage Services of Norfolk, Inc.
Granby at Olney Road, Norfolk 10, Virignia

December 20, 1956.

Home Savings & Loan Association
9245 Wilshire Boulevard
Beverly Hills, California

Attention: Mr. Kenneth D. Childs

Gentlemen:

This will serve to advise you that Mortgage Services of Norfolk, Inc., and Warren A. Ott of Norfolk, Virginia, have been designated as nominee by Mr. Harold L. Shaw under the commitment dated December 31, 1953, executed by Home Savings & Loan Association to Mr. Harold L. Shaw, and we are pleased to advise you that we hold an assignment from Mr. Shaw of all of his rights as his nominee under the aforesaid commitment of Home Savings & Loan Association.

We herewith accept the offer and commitment of Home Savings & Loan Association of December 31, 1953, to purchase loans described in Paragraph (2) of the said commitment in the total aggregate amount of $7,500,000.00, to be purchased by Home Savings & Loan Association, at par less 7.5% thereof.

Pursuant to Paragraph (2) of the commitment of December 31, 1953, executed by Home Savings & Loan Association by Mr. Howard Ahmanson, as President, to Mr. Harold L. Shaw, we are pleased

to formally tender to you $7,500,000.00 worth of permanent real estate loans guaranteed under provisions of the Servicemen's Readjustment Act of 1944, as Amended, and as specified in the said commitment.

We are ready, able and willing to make immediate delivery of these loans to Home Savings & Loan Association, and we request immediate delivery instructions as to place of delivery of the said loans and payment procedure.

Since physical delivery of all of these loans represents a heavy mechanical burden, to facilitate completion of transfer of the loans we are pleased to hand you herewith original loan documents and supporting documents in the sum aggregating $96,070.11, for which we will be pleased to accept your trust receipt for payment. [14]

The remainder of the loans, to aggregate a total of $7,500,000.00, is likewise available for immediate delivery to you, for which we request immediate delivery instructions and payment procedure.

Very truly yours,

MORTGAGE SERVICES
OF NORFOLK, INC.,

By /s/ WARREN A. OTT,
President.

/s/ WARREN A. OTT.

Duly verified.
Affidavit of Service by Mail attached.
[Endorsed]: Filed Sept. 30, 1957. [15]

[Title of District Court and Cause.]

MOTION OF DEFENDANT HOME SAVINGS AND LOAN ASSOCIATION TO DISMISS AMENDED COMPLAINT

Defendant Home Savings and Loan Association moves the Court pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss the Amended Complaint of Plaintiffs in the above matter on the grounds that such Amended Complaint fails to state a claim upon which relief can be granted and fails to join an indispensable party. This motion is based upon the pleadings and papers in the action and the Memorandum of Points and Authorities in Support of Defendant's Motion to Dismiss Amended Complaint attached hereto.

McKENNA AND FITTING,

By /s/ PAUL FITTING,
Attorneys for Defendant.

[Endorsed]: Filed Oct. 17, 1957. [18]

[Title of District Court and Cause.]

MINUTES OF THE COURT

October 28, 1957

Present: Hon. Leon R. Yankwich, District Judge;
Counsel for Plaintiff:
Maurice Hindin, Esq.
Counsel for Defendant:
Paul Fitting, Esq.

Proceedings:

Hearing on defendant's motion to dismiss:

Both sides argue.

Court makes statement.

It Is Ordered that defendant's motion to dismiss be and hereby is granted and further that defendant attorney prepare formal order and judgment accordingly.

JOHN A. CHILDRESS,
Clerk.

By /s/ L. CUNLIFFE,
Deputy Clerk. [37]

In the United States District Court for the Southern District of California, Central Division

No. 548-57Y

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Plaintiffs,

vs.

HOME SAVINGS AND LOAN ASSOCIATION, a Corporation,

Defendant.

JUDGMENT OF DISMISSAL

On the 28th day of October, 1957, before the Honorable Leon R. Yankwich, in Court Room No. 7 of the above-captioned Court, there came on regularly

for hearing the Motion of Defendant Home Savings and Loan Association to Dismiss the Amended Complaint on the grounds that such Amended Complaint failed to state a claim upon which relief could be granted and failed to join an indispensable party; McKenna and Fitting by Paul Fitting appearing for Defendant Home Savings and Loan Association, and Hindin and Susman and Edwin J. Regan by Maurice J. Hindin appearing for Plaintiffs.

The Court having considered the pleadings, the motion, and memoranda filed in the cause, and having heard arguments of counsel, and being fully advised in the premises, granted the Motion of Defendant Home Savings and Loan Association to Dismiss the Amended Complaint on the grounds that [38] such Amended Complaint failed to state a claim upon which relief could be granted and failed to join an indispensable party in that Plaintiffs purported to act and to sue as assignees of a written agreement which was not assignable and hence had no rights in the alleged written agreement on which the action was based, in that Plaintiffs were not the real parties in interest and the real party in interest had not acted or sued under the alleged agreement, and in that a waiver or estoppel was not and could not be pleaded as against Defendant.

Now, Therefore, It Is Hereby Ordered, Adjudged, and Decreed:

1. That Plaintiffs' Amended Complaint be and the same is hereby dismissed; and

2. That this Action be and the same is hereby dismissed; and

3. That Defendant Home Savings and Loan Association recover its costs in the amount of $.....

Dated: November 6, 1957.

/s/ LEON R. YANKWICH,
Judge of the United States
District Court.

Affidavit of Service by Mail attached.

[Lodged]: Nov. 1, 1957.

[Endorsed]: Filed Nov. 6, 1957. Entered Nov. 7, 1957. [39]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Warren A. Ott and Mortgage Services of Norfolk, Inc., a corporation, Plaintiffs above-named herein, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Judgment of Dismissal made in the above-entitled action on or about the 28th day of October, 1957, and which said Judgment of Dismissal was thereafter entered on the docket of the court on or about November 7, 1957.

Dated: November 12, 1957.

HINDIN AND SUSMAN, and
EDWIN J. REGAN,

By /s/ MAURICE J. HINDIN,
Attorneys for Appellants, Warren A. Ott and Mortgage Services of Norfolk, Inc., a Corporation.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Nov. 12, 1957. [41]

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 52, inclusive, containing the original:

Complaint, filed Apr. 30, 1957.
Minute Order of Court, 9/9/57.
Amended Complaint, filed Sept. 30, 1957.
Notice of Motion of Defendant Home Savings and Loan Association to Dismiss Amended Complaint.
Minute Order of Court, 10/28/57.
Judgment of Dismissal.
Notice of Appeal.

Designation of Contents of Record on Appeal.

Statement of Points to be Relied Upon by Plaintiffs and Appellants.

Undertaking for Costs on Appeal.

Appellee's Designation of Additional Contents of Record on Appeal.

I further certify that my fee for preparing the foregoing record, amounting to $1.60 has been paid by appellant.

Dated: November 22, 1957.

[Seal] JOHN A. CHILDRESS,
Clerk.

By /s/ WM. A. WHITE,
Deputy Clerk.

[Endorsed]: No. 15804. United States Court of Appeals for the Ninth Circuit. Warren A. Ott and Mortgage Services of Norfolk, Inc., a Corporation, Appellants, vs. Home Savings & Loan Association, a Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed November 25, 1957.

Docketed: December 3, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 15804

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Appellants,

vs.

HOME SAVINGS & LOAN ASSOCIATION, a Corporation,

Appellee.

STATEMENT OF POINTS UPON WHICH APPELLANTS INTEND TO RELY AND DESIGNATION OF THE RECORD

Pursuant to Rule 17(6), of Rules of this Court, Appellants herewith present a concise statement of the points on which they intend to rely, as follows:

1. That the District Court erred in granting the Defendant's Motion to dismiss the Plaintiffs' Amended Complaint herein.

2. That the District Court erred in entering a judgment of dismissal against the Plaintiffs and Appellants herein on the Amended Complaint.

3. That the District Court erred in holding in connection with the judgment of dismissal as a matter of law that Plaintiffs and Appellants herein

were not assignees of the agreement set forth and alleged in the Amended Complaint.

4. That the District Court erred in holding in connection with the judgment of dismissal that the aforesaid agreement set forth and alleged in the Amended Complaint was not assignable, and that the Plaintiffs and Appellants herein are not competent persons as assignees thereunder to maintain the action set forth in the Amended Complaint.

5. That the District Court erred in holding that the Plaintiffs and Appellants herein, as assignees, were not the real parties in interest.

6. That the District Court erred in holding in connection with the judgment of dismissal that a waiver or estoppel on the part of the Defendant and Appellee in recognizing and dealing with the Plaintiffs and Appellants herein was not and could not be pleaded as against the Defendant and Appellee in the said Amended Complaint.

7. That the District Court erred in denying to the Plaintiffs and Appellants herein the right to a trial by jury of issues of fact set forth in the Complaint, no evidence relative to such issues of fact having been offered or presented to the trial court.

8. That the District Court erred in holding as a matter of law that the Amended Complaint did not state facts sufficient upon which any relief could be afforded to the Plaintiffs and Appellants herein.

Appellants herein designate all of the record which is material to the consideration of the appeal, as follows:

1. The Amended Complaint together with Exhibits attached thereto.

2. Motion of Defendant, Home Savings & Loan Association, to dismiss the Amended Complaint.

3. Order of the Court granting Defendant's Motion to dismiss the Amended Complaint.

4. Judgment of Dismissal.

5. Plaintiffs' Notice of Appeal.

6. Statement of Points to be Relied upon by Plaintiffs' and Appellants.

7. Designation of Contents of Record on Appeal.

Dated: November 29, 1957.

/s/ MAURICE J. HINDIN,
Attorney for Appellants.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Dec. 2, 1957.

[Title of District Court and Cause.]

APPELLEE'S DESIGNATION OF ADDITIONAL PARTS OF THE RECORD ON APPEAL

Appellants having served upon Appellee their Statement of Points Upon Which Appellants Intend to Rely and Designation of the Record, pursuant to paragraph 6 of Rule 17 of the Rules of this Court Appellee hereby designates the following additional parts of the record which are material to the consideration of the Appeal herein:

1. Original Complaint filed April 30, 1957.

2. Minute Order of the Court of September 9, 1957.

3. Appellee's Designation of Additional Contents of Record on Appeal.

Dated: December 4, 1957.

McKENNA AND FITTING,

By /s/ PAUL FITTING,
Attorneys for Appellee.

[Endorsed]: Filed Dec. 6, 1957.

No. 15804

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Appellants,

vs.

HOME SAVINGS & LOAN ASSOCIATION, a Corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

MAURICE J. HINDIN,
6505 Wilshire Boulevard,
Los Angeles 48, California,
Attorney for Appellants.

The Myers Legal Press, Los Angeles. Phone VAndike 9007.

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TABLE OF AUTHORITIES CITED

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No. 15804

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a Corporation,

Appellants,

vs.

HOME SAVINGS & LOAN ASSOCIATION, a Corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

Statement of Pleadings and Facts Disclosing Basis of Jurisdiction.

This in an appeal from a Judgment of Dismissal made and entered in the United States District Court for the Southern District of California, Central Division.

The only operative and effective pleading involved in this appeal is the Amended Complaint which is set forth at length at Transcript of Record, pages 8-17. To the Amended Complaint, the Defendant filed a Motion to Dismiss the Complaint, a copy of the said Motion being set forth at length in the Transcript of Record, page 18. The District Court thereupon granted the Motion of the Defendant to dismiss the action and entered a judgment of dismissal. The court's Order and Judgment are set forth in the Transcript of Record, at pages 18-21, respectively.

Jurisdiction of the United States District Court in this action is conferred by provisions of Title 28, United States Code, Section 1332, and the jurisdictional facts alleged in Paragraphs I, II and III of the Amended Complaint.

The jurisdiction of this court is based upon Title 28, United States Code, Section 1291.

The Judgment of Dismissal made and entered in the District Court in this action is a final decision of the District Court and is an appealable judgment. *Mantin v. Broadcast Music, Inc.,* 244 F. 2d 204; *Wright v. Gibson,* 128 F. 2d 865.

Concise Statement of the Case.

The Amended Complaint alleges the execution of an agreement in writing on December 31, 1953, by the terms of which agreement the Defendant, Home Savings & Loan Association, agreed to purchase from one Harold L. Shaw, or his nominee, within three (3) years from date of the said agreement, up to $7,500,000.00 worth of permanent real estate loans to be guaranteed under provisions of Servicemen's Readjustment Act of 1944, as Amended. A copy of the agreement itself was incorporated in the Amended Complaint and marked "Exhibit A". The Amended Complaint further alleges that on or about the 10th day of November, 1956, Harold L. Shaw, by an instrument in writing, designated and appointed the Plaintiffs herein as his nominee under the aforementioned agreement and by the same instrument in writing assigned, set over and transferred to the Plaintiffs all of his right,

title and interest in and to the aforesaid agreement. A copy of this instrument was likewise attached to the Amended Complaint and incorporated therein by reference and marked "Exhibit B". The Amended Complaint further alleges that after the execution of the instrument designating the Plaintiffs as nominees and assigning to the Plaintiffs all of Harold L. Shaw's rights in and to the agreement, the Plaintiffs notified the Defendant of their nomination and assignment, and between the 5th day of December, 1956, and the 8th day of January, 1957, the Defendant recognized, acknowledged and dealt with the Plaintiffs as the assignees of Harold L. Shaw.

The Amended Complaint further alleged that on or about the 20th day of December, 1956, and within three (3) years of date of execution of the agreement in writing, the Plaintiffs tendered to the Defendant and offered to sell and deliver to it $7,500,000.00 worth of permanent real estate loans of the nature and type described in the original agreement. The tender was by an instrument in writing which was attached to the Complaint and marked "Exhibit C". The Amended Complaint further alleges that the Plaintiffs duly performed all the terms and conditions of the agreement in writing, and that they were at all times ready, able and willing to perform all the terms and conditions of the said agreement. The Amended Complaint further alleged that the Defendant, in breach of its contract, failed and refused to purchase from the Plaintiffs the said real estate loans, and that as a direct and proximate result of the acts of the De-

fendant the Plaintiffs were damaged in the sum of $237,135.80.

The entire Amended Complaint and all of the exhibits and documents referred to in the Complaint are set forth in full in the Transcript of Record at pages 8-17.

The Defendant herein thereupon filed its Motion to dismiss the Complaint. The Motion to dismiss the Complaint was made upon two grounds: (1) The Amended Complaint fails to state a claim upon which relief can be granted; and (2) The Amended Complaint fails to join an indispensable party. A copy of the Motion is set forth in the Transcript of Record at page 18.

Question Presented.

A single question is presented by this appeal. It may be succinctly stated, as follows: Did the District Court err in entering a judgment of dismissal on the Amended Complaint in this action?

An analysis of this basic question reveals three pertinent subsidiary questions. They are:

(a) Does the use of the words "or his nominee" constitute a covenant against assignment?

(b) Is the determination of whether the use of these words constitute a covenant against assignment a question of law or is it a question of fact to be determined upon trial?

(c) If these words do constitute a covenant against assignability, is there an issue of fact as to waiver to be determined on trial of the case?

ARGUMENT.

I.

The Court Erred as a Matter of Law in Granting Defendant's Motion to Dismiss and in Entering Judgment of Dismissal on the Amended Complaint.

The Agreement of December 31, 1953 [T. R. pp. 13-14] makes no reference to assignability. The District Court in its Judgment of Dismissal upheld the contention of the Defendant, however, that the use of the words "or his nominee" in the agreement of December 31, 1953, constituted in effect a covenant against assignability of the agreement.

Inherent in the Judgment of Dismissal are certain necessary findings of fact and law by the trial court. The following implied or expressed findings are not supported by the facts and are erroneous as a matter of law:

A. That the contract of December 31, 1953, was not an assignable contract (this is a mixed question of law and fact).

B. That the Plaintiffs were not and could not as a matter of law be assignees of the contract and that the assignment to the Plaintiffs was invalid or of no legal effect.

C. That the Defendant did not or could not waive or consent to an assignment of the contract to the Plaintiffs if the same were nonassignable (this is also a mixed question of law and fact).

D. That the Defendant could not be estopped as a matter of fact or of law to deny the validity of an assignment to the Plaintiff (this is a mixed question of law and fact).

E. That the Plaintiffs' assignor, Harold L. Shaw, was an indispensable party to the action as a party plaintiff.

It is respectfully submitted that certain basic considerations are applicable in the determination of the question involved on this appeal. The facts as alleged in the Amended Complaint were not put in issue and, therefore, for purposes of determination of the Motion to Dismiss, the Court was required as a matter of law to consider as true all of the allegations of the Complaint. For purposes of consideration of the Motion to Dismiss, the court on appeal must also consider all of the allegations of the Complaint as true. *Leimer v. State Mutual Life Assurance Co.* (C. C. A. 8th), 108 F. 2d 203; *Yuba Consolidated Gold Fields v. Kilkeary* (C. C. A. 9th), 206 F. 2d 884.

Also on a Motion to Dismiss, the allegations of the Complaint must be viewed in a light most favorable to the Plaintiff. *Sidebothan v. Robison* (C. C. A. 9th), 216 F. 2d 816; *Yuba Consolidated Gold Fields v. Kilkeary* (C. C. A. 9th), 206 F. 2d 884.

Further, it has become well established that a Motion to Dismiss should be granted sparingly and with caution, and that serious questions of law should not be disposed of summarily by a Motion to Dismiss. *Chicago and Northwestern Railway v. Chicago Packaged Fuel Company* (C. C. A. 7th), 183 F. 2d 630. It has been held that in breach of contract actions where meaning of the contract is doubtful, questions relating to the interpre-

tation or the meaning of the contract should not be decided on a Motion to Dismiss but should be held for full trial. *R. E. Crummer v. Nuveen* (C. C. A. 7th), 147 F. 2d 3, 157 A. L. R. 739. Matters relating to proper construction of a contract sued upon should not be determined on a Motion to Dismiss but should be reserved to full trial. *McLaughlin v. Union Switch & Signal Co.* (C. C. A. 3rd), 166 F. 2d 46.

Defendant's Motion to Dismiss is based on the Defendant's argument that (1) the contract of December 31, 1953, by its terms, was nonassignable; and (2) assuming that it was nonassignable, the assignment executed by Harold L. Shaw in favor of the Plaintiffs could confer no rights on the Plaintiffs as assignees, and (3) if the Plaintiffs sought to maintain the action as a nominee of Shaw, as distinguished from his assignee, then they must, of necessity, join Harold L. Shaw as a party plaintiff since a nominee as such and standing alone may not maintain an action in his capacity as nominee.

Plaintiffs concede that if the assignment to them fails and if they are mere nominees of Harold L. Shaw and not assignees of Harold L. Shaw's rights in and to the agreement, then it would be necessary for Harold L. Shaw to be joined with the Plaintiffs. But Plaintiffs urge and contend that (1) the contract does not by its terms contain any covenant against assignment, and (2) the assignment to the Plaintiffs by Shaw of all of his rights in and to the contract was a valid and enforceable assignment, and (3) that even if the agreement by its terms could be held to be nonassignable, under the applicable state law such nonassignability can be waived, and that in this case the Defendant did in fact, by its conduct, waive any restriction against assignability if indeed the agreement was in fact nonassignable.

Appellants further contend that all of these issues turn on questions of fact or on mixed questions of law and fact and should be determined upon trial rather than by a motion to dismiss the action.

In support of Plaintiffs' contentions, the following propositions of law are respectfully urged:

A. The Law of California Favors the Interpretation of the Assignability of Contracts Over Nonassignability.

1. The general rule is that in the absence of an express covenant against assignments, a contract which does not involve personal skill, trust or confidence is assignable without the consent of the other party.

Larue v. Groezinger, 84 Cal. 281, 24 Pac. 42;

Panhandle Lumber Co. v. Mackay (9th Cir.), 21 F. 2d 916.

2. Assignability of rights under a contract must be determined by the law of the jurisdiction where the contract was executed. The agreement by its terms was executed in the State of California.

Dix v. Bank of Cal. Nat. Assn., 113 Fed. Supp. 823, affd. 205 F. 2d 957.

B. Assignability of a Contract Is the Basic Policy of the Law, Nonassignability the Exception.

1. In the case of *Larue v. Groezinger,* 84 Cal. 287, 24 Pac. 44, the Supreme Court used the following language:

> "If the language of the contract does not exclude the idea of performance by another and the nature of the thing contracted for or the circumstances of the case do not show that the skill, credit or other personal quality or circumstance of the party was

a distinctive characteristic of the thing stipulated for or a material inducement to the contract then the contract is assignable."

2. In *Rued v. Cooper,* 109 Cal. 682, 34 Pac. 98, the Supreme Court of California, used the following language:

> "Assignability of things in action is now the rule, nonassignability the exception, and this exception is confined to wrongs done to the person, the reputation, or the feelings of the injured party and to contracts of a purely personal nature like promises of marriage."

3. The statutes of the State of California favor free assignability.

Cal. Civ. Code, Secs. 954, 1044, 1458;

Webb v. Pillsbury, 23 Cal. 2d 324, 144 P. 2d 1;

Everts v. Fawcett, 24 Cal. App. 2d 213, 74 P. 2d 815;

Jackson v. Deauville Holding Co., 219 Cal. 498, 27 P. 2d 643;

Wilkstrom v. Yolo Fliers Club, 206 Cal. 461, 274 Pac. 959.

C. The Language of the Contract Does Not Specifically Covenant Against Assignability.

1. While the law of the State of California favors assignability rather than nonassignability, nevertheless, the parties to a contract may specifically contract against assignability.

Murphy v. Luthy Battery Co., 74 Cal. App. 68, 239 Pac. 341.

2. However, covenants restricting assignability, being contrary to the general policy of the law which favors

assignability, require clear and unequivocal language and are strictly construed. In discussing this same problem, the Supreme Court of the State of New York in the case of *Allhusen v. Caristo Construction Company,* 303 N. Y. 446, 103 N. E. 891, used the following language:

> "Clear language should, therefore, be required to lead to the conclusion that the certificates are not assignable. We cannot deduce such consequence from uncertain language."

3. In the absence of clear and unequivocal language to the contrary, assignability of contractual rights is favored in the law. The Supreme Court of California declared, as follows: "It hardly needs citation of authority to the principle that covenants limiting the free alienation of property such as covenants against assignments are barely tolerated and must be strictly construed", in the case of *Chapman v. Great Western Gypsum Co.,* 216 Cal. 420, 14 P. 2d 758.

4. If the agreement is ambiguous as to the question of assignability, such ambiguity must be resolved against the person creating the ambiguity. Here the agreement was written by the Defendant and any ambiguity, at least at the dismissal stage, should be resolved against the Defendant.

Cal. Civ. Code, Sec. 1654.

5. In the final analysis, the interpretation of any contract lies in the intention of the parties. Intent is always a question of fact and should be determined after a trial on the merits rather than by means of a motion.

D. The Use of the Words "or His Nominee" Does Not Preclude the Possibility of an Assignment.

1. The use of the phrase in the agreement of December 31, 1953 [T. R. pp. 13-14], "to your nominee" in no way connotes a restriction against assignment but on the contrary expressly indicates the intention of the parties not to restrict the dealings to the named party but to deal with another party or grantee of such party. Webster's New International Dictionary, Second Edition, Unabridged, 1948, defines "nominee", as follows: "The person named, as the recipient in an annuity or grant".

2. In the *Schuh Trading Co. v. Commissioner of Internal Revenue* case, 95 F. 2d 404, 411 (7th Cir.), the court used the following language: "The word 'nominee' ordinarily indicates one designated to act for another as his representative in a rather limited sense. It is used sometimes to signify an agent or trustee. It has no connotation, however, other than that of acting for another in representation of another *or as grantee of another*". (Italics ours.)

Pursuing the term "grantee" as the same is used in the dictionary definition and in the foregoing *Schuh* case, we find that the term "grantee" is synonymous with "assignee". The terms are, therefore, interchangeable.

Nolan v. City of New York, 39 N. Y. S. 2d 360, 179 Misc. 1011;

Ely v. Commissioner, 49 Mich. 17, 12 N. W. 893;

Black's Law Dictionary, 4th Ed., p. 152.

The only case in California (and in any other state for that matter) purporting to define, judicially, the term "nominee" is *Cisco v. Van Lew,* 60 Cal. App. 2d 575, 141 P. 2d 433.

In the case of *Cisco v. Van Lew,* 60 Cal. App. 2d 575, 141 P. 2d 433, a person designated as a nominee instituted an action for specific performance to compel the other party to the escrow to perform his terms of the escrow. The court pointed out that no assignment was made by the original party to the escrow in favor of the nominee. The question then presented to the court was whether or not a person designated as a nominee could, in the absence of an assignment, enforce by specific performance the provisions of an escrow. The court in that instance indicated that the mere designation of a nominee gave such a person no right of specific performance, and in that connection the court used the following language:

> "In the absence of an assignment from McGuire to the Ciscos or some other effective substitution of the Ciscos for McGuire as the purchasers, no rights became vested in the Ciscos which they are entitled to assert on their own behalf independently of McGuire".

The language of the case clearly implies that the designation of a nominee is not repugnant to an assignment of contractual rights to such nominee. The court clearly stated, "In the absence of an assignment . . . no rights became vested in the Ciscos".

It is respectfully submitted that the *Cisco v. Van Lew* case is not authority for the proposition that a nominee cannot be an assignee, nor is it authority for the proposition that use of the term "nominee" excludes possibility of a person named as a nominee from being an assignee if a proper assignment is made by him. Neither is the case authority for the proposition that the use of the term "nominee" precludes or prevents assignability of the contract.

Defendant herein concedes that under authority of the *Cisco v. Van Lew* case in the absence of an assignment of the Shaw contract to the Plaintiffs herein, the Plaintiffs would have no rights to specific performance of the agreement in their own names as nominees without joining Mr. Shaw as a party plaintiff. However, in this case, the Plaintiffs herein secured a valid assignment of all of Shaw's rights in writing, and gave timely notice of the assignment to the defendant. As such, therefore, they are not acting as mere nominees but are acting as assignees of Shaw's rights under the agreement.

It is, therefore, respectfully submitted that the trial court was not justified in holding as a matter of law that the use of the term "or his nominee" was the equivalent of an express covenant against assignability. It is respectfully submitted that the use of the term "nominee" does not as a matter of law exclude the possibility of assignability.

By its very definition a nominee may be also a grantee (which is synonymous with assignee). To hold that the possibility of assignment is precluded, goes contrary not only to definition but also to the policy of the law of California which favors the interpretation of assignability over nonassignability.

E. The Meaning of the Words "or His Nominee" May Properly Be Explained on Trial by Parol Evidence.

1. The contract is silent as to the question of assignability. It is not necessary to resort to parol evidence to vary or explain the term "nominee".

2. But assuming for purposes of argument that the use of the term "nominee" may connote by definition an intention against assignment, the parties to the action should be permitted to explain the custom and usage of

the words "or his nominee" as the same are used in the trade and business of buying and selling mortgages. The District Court of Appeal of the State of California in the case of *Body Steffner v. Flotill Products, Inc.*, 63 Cal. App. 2d 555, at page 558, 147 P. 2d 84, used the following language:

> "It is the rule of practically universal acceptation in common law jurisdiction that however clear and unambiguous the words of a particular contract may appear on its face it is always open to the parties to the contract to prove that by the general and accepted usage of the trade or business in which both parties are engaged and to which the contract applies the words have acquired a meaning different from their ordinary and popular sense".

This language was approved in the very recent case of *Peskin v. Squires,* 156 A. C. A. 268.

3. Likewise, in connection with the construction of a contract or the interpretation of words used therein, it is proper for the court to consider the practical construction given to the contract by the parties and their conduct thereunder. *Maguire v. Lees,* 74 Cal. App. 2d 697, 169 P. 2d 411.

4. Evidence of the circumstances surrounding an agreement and subsequent conduct of the parties thereto as affecting the intention of the parties is admissible by parol evidence.

Cal. Civ. Code, Secs. 1647, 1655, 1644, 1645;
Norton v. Whitehead, 84 Cal. 263, 24 Pac. 154.

F. The Nature of the Contract Does Not Favor an Interpretation Against Assignability.

1. Option agreements and all benefits under the same may be assigned in the absence of an express provision to the contrary.

Tatum v. Levi, 117 Cal. App. 83, 3 P. 2d 963.

2. The agreement in question does not stipulate or provide either as a fact or as a matter of law that it is a personal service agreement requiring the personal skill, trust or confidence of Mr. Shaw. The agreement is to purchase items of property, to-wit, mortgages, secured and guaranteed by an instrumentality of the Government. On the face of the agreement, no personal service or personal skill, trust or confidence is involved any more than in the purchase of any object of property by one person from another. If personal service or skill of Mr. Shaw was intended by the parties, such fact is one of defensive material and may be shown by the defendant upon trial, but should not be determined upon a Motion for dismissal. On its face, no personal skill is involved and none should be inferred on a Motion to Dismiss.

G. Even a Covenant Against Assignability May Be Waived by the Parties.

1. Assuming for purpose of argument only that the use of the term "or his nominee" was the equivalent of an express covenant against assignment, such a covenant against assignments may be waived by the parties by sub-

sequent dealings with the assignee or by recognizing the status of the assignee as a real party in interest.

Trubowitch v. Riverbank Canning Co., 30 Cal. 2d 335, 182 P. 2d 182;

California Packing Corp. v. Lopez, 207 Cal. 600, 279 Pac. 664;

Maguire v. Lees, 74 Cal. App. 2d 697, 169 P. 2d 411.

2. The issue of the waiver of even an express contractual covenant against assignment is a question of fact and as such should be determined upon trial of the action and should not be disposed of on motion for dismissal.

Maguire v. Lees, 74 Cal. App. 2d 697, 169 P. 2d 411.

3. The ultimate fact of a waiver was pleaded in the Amended Complaint [Paragraph IX, Amended Complaint, T. R. p. 11].

4. If a party to a contract with knowledge of an assignment recognizes and deals with the assignee, the right to object to an assignment is waived.

5 *Cal. Jur.* 2d (Assignments), p. 294.

H. Motions to Dismiss Should Not Be Granted Unless It Appears Certain That the Plaintiff Would Be Entitled to No Relief Under Any State of Facts Which Can Be Proved in Support of Its Claims.

The test is whether or not in the light of facts pleaded which are most favorable to the Plaintiff, and indulging in every intendment regarded in its favor, the complaint is sufficient to constitute a valid claim.

United States v. Thurston County, 54 Fed. Supp. 201, affd. 149 F. 2d 485, cert. den. 326 U. S. 744, 66 S. Ct. 58, 90 L. Ed. 444;

Frederick Hart v. Recordgraph Corp., 169 F. 2d 580;

Barron and Holtzoff: Federal Practice and Procedure, Volume 1, pages 604 ff.

I. The Assignees Are Proper Parties Plaintiff to This Action and It Is Not Necessary to Join the Assignor as a Party Plaintiff.

1. Plaintiffs assert their right to maintain this action as the owners and holders of all of Harold Shaw's rights under the agreement by virtue of their assignment from Shaw. An assignment carries with it all of the rights of the assignor including the right to maintain legal action by the assignees alone and in their own name.

Union Supply Co. v. Morris, 220 Cal. 331, 30 P. 2d 394;

Cal. Civ. Code, Sec. 1084.

2. Only if it is held that as a matter of fact and of law that (1) Plaintiffs herein are not assignees but mere nominees only and (2) further that the agreement is not capable of assignment and (3) that the restriction against assignment is not capable of being waived, does it become proper to hold that Harold Shaw need be joined as a party plaintiff. It is submitted that none of these conclusions is warranted in this case.

Summary of Arguments.

As a summary of Appellants' contentions, it is respectfully submitted that the judgment of dismissal should be reversed for the following grounds:

1. The agreement is silent as to the matter of assignment.

2. The use of the words "or his nominee" is not the equivalent in law or in fact of a covenant against assignability.

3. The law of California with reference to assignments favors interpretation of assignability over non-assignability.

4. All questions of fact should on a motion to dismiss be resolved in Appellants' favor.

5. Questions of assignability relate to the intent of the parties which should be determined upon trial, not on a motion to dismiss.

6. Even if the words "or his nominee" can be construed to be the equivalent of a covenant against assignability, such a covenant is subject to waiver by the conduct of the parties. Waiver is a matter of fact to be determined upon trial.

Conclusion.

It is respectfully submitted that the judgment of the District Court should be reversed and the cause remanded with instruction to the District Court to require the Defendant to plead to the Amended Complaint.

Respectfully submitted,

MAURICE J. HINDIN,

Attorney for Appellants.

No. 15804

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WARREN A. OTT and MORTGAGE SERVICES OF NORFOLK, INC., a corporation,

Appellants,

vs.

HOME SAVINGS AND LOAN ASSOCIATION, a corporation,

Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

I.

Jurisdictional Statement.

This appeal is from a judgment of dismissal [R.[1] 19-21] entered in the United States District Court for the Southern District of California, Central Division, dismissing Appellants' First Amended Complaint.

Paragraphs I, II and III of Appellants' First Amended Complaint allege diversity of citizenship and an amount in controversy of over Three Thousand Dollars [R. 8-9]. The District Court had jurisdiction under Section 1332 of Title 28 of the United States Code.

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[1]"R" is used herein to refer to the pages of the printed Transcript of Record.

The District Court granted Appellee's motion to dismiss Appellants' First Amended Complaint on the grounds that it failed to state a claim upon which relief could be granted and failed to join an indispensable party [R. 18-19]. Thereupon, judgment of dismissal was entered and filed on November 6, 1957 [R. 19-21]. Notice of appeal was filed on November 12, 1957 [R. 21-22]. This Court has jurisdiction under Section 1291 of Title 28 of the United States Code.

II.

Concise Statement of Facts.

Appellants Warren A. Ott and Mortgage Services of Norfolk, Inc. brought an action for damages for alleged breach of contract against Appellee Home Savings and Loan Association [Amended Complaint, R. 8-13]. Appellee filed a motion to dismiss the Amended Complaint for failure to state a claim upon which relief could be granted and for failure to join an indispensable party [R. 18], in that the alleged contract was between Appellee and one Shaw or his "nominee", that such contract was not assignable, but Appellants were suing as assignees and not as nominees, and that an indispensable party, Shaw, was lacking.

The alleged contract is in the form of a letter, the material terms of which are [Par. VI, and Ex. A, Amended Complaint, R. 10, 13-14]:

"December 31, 1953

Mr. Harold L. Shaw
650 South Spring Street
Los Angeles 14, California

Dear Mr. Shaw:

This letter is to serve as a binding commitment, for a period of three years from date hereof, upon Home Savings and Loan Association to make to you or your nominee the following loans:

. . . . . .

(2) In addition to the above, Home agrees to purchase from you or your nominee up to Seven and One Half Million Dollars ($7,500,000) of permanent real estate loans to be guaranteed under the provisions of the Servicemen's Readjustment Act of 1944, as amended. Said loans shall have a maturity date of Twenty-nine years. The purchase price of said loans to be at par less Seven and One Half Per Cent (7½%) thereof.

Yours very truly,
HOME SAVINGS AND LOAN ASSOCIATION
S/ Howard F. Ahmanson
President"

Appellants Ott and Mortgage Services of Norfolk, Inc. allege that their rights in such alleged written agreement arise out of a paper which reads [Par. VII, and Ex. B, Amended Complaint, R. 10-11, 15]:

"DESIGNATION OF NOMINEE AND ASSIGNMENT OF COMMITMENT

FOR AND IN CONSIDERATION of Ten ($10.00) Dollars and other good and valuable consideration, I, the undersigned HAROLD L. SHAW, herewith designate and appoint MORTGAGE SERVICES OF NORFOLK,

INC., and WARREN A. OTT, of Norfolk, Virginia, as my Nominee under that certain commitment executed December 31, 1953, by Home Savings and Loan Association, by Howard Ahmanson, President, to the undersigned, a copy of which said loan commitment is attached hereto.

I, the undersigned HAROLD L. SHAW, herewith assign, set over and transfer unto MORTGAGE SERVICES OF NORFOLK, INC., and WARREN A. OTT, as my nominee, all of my right, title and interest in and to the aforesaid commitment and all of my rights thereunder.

DATED: 10th day of November, 1956.

s/ Harold L. Shaw

FOREGOING ASSIGNMENT IS ACCEPTED:

DATED: November 15, 1956

MORTGAGE SERVICES OF NORFOLK, Inc.

By s/ Warren A. Ott,
President

Warren A. Ott"

Appellants further allege that as a result of such paper they "are the owners and holders of all the right, title and interest of the said Harold L. Shaw in and to the agreement in writing. . . ." [Par. VII, R. 11], and that Appellee was notified thereof on December 5, 1956 [Par. VIII, R. 11].

The Amended Complaint contains no allegations of a tender of loans by Shaw, or by Appellants on behalf of Shaw or as nominees of Shaw. It does allege that "the Plaintiffs tendered to the Defendant and offered to sell and deliver to the Defendant" certain loans [Par. X, R. 11].

Appellants also rely upon a letter of December 20, 1956 [Par. X and Ex. C, Amended Complaint, R. 12, 16-17], which reads in part:

"MORTGAGE SERVICES of Norfolk, Inc. Granby at Olney Road, Norfolk 10, Virginia

December 20, 1956

Home Savings & Loan Association
9245 Wilshire Boulevard
Beverly Hills, California

Attention: Mr. Kenneth D. Childs

Gentlemen:

This will serve to advise you that Mortgage Services of Norfolk, Inc., and Warren A. Ott of Norfolk, Virginia, have been designated as nominee by Mr. Harold L. Shaw under the commitment dated December 31, 1953, executed by Home Savings & Loan Association to Mr. Harold L. Shaw, and we are pleased to advise you that we hold an assignment from Mr. Shaw of all of his rights as his nominee under the the aforesaid commitment of Home Savings & Loan Association.

We herewith accept the offer and commitment of Home Savings & Loan Association. . . .

. . . we are pleased to formally tender to you $7,500,000 worth of permanent real estate loans . . .

We are ready, able and willing to make immediate delivery . . .

. . . . . .

Very truly yours,
MORTGAGE SERVICES
of Norfolk, Inc.
By s/ Warren A. Ott
President
s/ Warren A. Ott"

Shaw is not a party to the Amended Complaint, nor do Appellants anywhere allege they were acting in his behalf, or are now suing in his behalf.

The Amended Complaint was filed by Appellants with leave of court granted at a hearing on motions for summary judgment addressed to the original Complaint [R. 7-8]. The Amended Complaint, in addition to other matters not appearing in the original Complaint, for the first time alleged in general terms that Appellee dealt with Appellants as assignees, and that Appellants changed their position in reliance thereon [Par. IX of Amended Complaint, R. 11].

III.
Summary of Argument.

Under the parol evidence rule, evidence cannot be introduced to vary the terms of a written agreement. The alleged written agreement on which Appellants sue was to purchase loans from "you [Harold L. Shaw] or your nominee". A nominee is a person acting for or standing in the place of the owner, and a nominee has no claim of ownership in his own right. By contrast, an assignee has an interest in his own right as owner. The status of nominee is inconsistent with that of holder of all right, title, and interest, or that of assignee. The use of the word "nominee", particularly in the absence of any provision for assignment, makes the contract non-assignable, and evidence cannot be introduced to vary the express language. The Amended Complaint is defective in the following respects, each of which is fatal:

1. Appellee's offer to buy ran until December 31, 1956. No tender by Shaw of any loans whatever is alleged, nor by Appellants for Shaw. The tenders alleged are by Appellants on their own behalf and in their own interest. Hence, Shaw or his "nominee" has never acted under the contract, and the offer has lapsed.

2. Appellants nowhere allege they are suing for Shaw or on his behalf. On the contrary, the Amended Complaint as a whole makes it clear Appellants are not suing as nominees but as owners by assignment. As such, they have no rights under the contract.

3. If it can be argued that Appellants are suing as nominees, they are not the real party in interest. The principal, not the nominee, is the real party in interest. The real party in interest, Shaw, is not made a party, although he is an indispensable party.

Appellants concede that if there can be no assignment and they are mere nominees, Shaw is a necessary party (A. B.[2] 7, 13).

Finally, the allegations of the Amended Complaint that there was a waiver of non-assignability are vague and unsupported by specific facts, and are contradicted by the specific facts alleged in the Complaint.

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[2]"A. B." is used herein to refer to the pages of Appellants' printed Opening Brief.

IV.

A "Nominee" Is One Who Acts for Another, and Is Not an Assignee.

A "nominee" is one designated to act for another, in the right of the other in a limited sense.

The word "nominee" has a limited meaning, and a *nominee* has no rights in or to his principal's contract.

Cisco v. Van Lew, 60 Cal. App. 2d 575, 141 P. 2d 433 (1943);

Schuh Trading Company v. C. I. R., 95 F. 2d 404 (7th Cir., 1938);

B. F. Avery & Sons Co. v. Glenn, 16 Fed. Supp. 544 (W. D. Ky. 1936);

28A *Words and Phrases,* 316, 317.

In *Cisco v. Van Lew, supra,* defendant listed real property with McGuire for sale. McGuire received an offer of $2,000 from Cisco, and of a higher price from Cohn. McGuire did not tell defendant of the Cohn offer, and persuaded defendant to open an escrow with McGuire for $2,000, title to vest in J. H. McGuire, "or his nominee", because McGuire could not remember the purchaser's name. McGuire later filed a paper in the escrow stating that title was to be vested in Cisco. Defendant later heard of the Cohn offer and rescinded. Cisco and McGuire brought suit for specific performance and commissions.

The Court denied relief on the grounds that Cisco, not having been named in the document signed by defendant, could not get specific performance, and that if Cisco was

suing as nominee he stood in the position of McGuire and was barred by unclean hands. The Court said (60 Cal. App. 2d 583-584):

> "There appears to be no uncertainty or ambiguity as to the sense in which the words 'his nominee' are used. They mean simply that title is to be 'shown' as vested either in McGuire himself or such person or persons as McGuire should designate to receive title in his behalf . . . The word 'nominee' in its commonly accepted meaning, connotes the delegation of authority to the nominee in a representative or nominal capacity only, and does not connote the transfer or assignment to the nominee of any property in or ownership of the rights of the person nominating him.
>
> . . . . . .
>
> ". . . In the absence of an assignment from McGuire to the Ciscos or some other effective substitution of the Ciscos for McGuire as the purchasers, no rights become vested in the Ciscos which they are entitled to assert on their own behalf independently of McGuire. At best, they are but nominal parties seeking to enforce some right or rights of McGuire and not their own, and therefore the Ciscos have failed to establish any right or interest in the subject matter of the action which they, as mere nominees of McGuire, are entitled to have specifically enforced."

The Court relied upon *Schuh Trading Company v. C. I. R.*, 95 F. 2d 404 (7th Cir., 1938). The Commissioner there contended there was no reorganization under the tax laws on the grounds that McKesson & Robbins was not a party to the transaction because assets that by contract were to go to McKesson & Robbins "or its

nominee" went to a fully owned subsidiary as nominee. In denying this contention, the Court said (95 F. 2d 411):

> ". . . The word nominee ordinarily indicates one designated to act for another as his representative in a rather limited sense. It is used sometimes to signify an agent or trustee. It has no connotation, however, other than that of acting for another, in representation of another, or as the grantee of another . . . The mere fact that McKesson & Robbins, the active party to the contract of reorganization, directed that the assets should be transferred to its nominee instead of directly to itself in nowise detracts from the fact that McKesson & Robbins contracted to receive and did in fact receive through its nominee that which it contracted for."

In *B. F. Avery & Sons Co. v. Glenn,* 16 Fed. Supp. 544 (W. D. Ky. 1936), in a question of whether stamp taxes were due on a transfer of stock to a trustee under a voting trust, the Court distinguished a cited case involving a transfer to a nominee, saying (16 Fed. Supp. 547-8):

> "There is a substantial difference between a nominee and a trustee. A nominee is synonymous with an agent to receive property in futuro and one who represents and acts for his principal, and the principal is bound by what he does in discharge of the agency. A trustee is not an agent, but a person in whom some estate, interest, or a power in or affecting property is vested for the benefit of another."

So well established is the meaning of "nominee" that cases assume it without discussion. Thus, when Mr. Justice Brandeis, in *Founders General Co. v. Hoey,* 300 U. S. 268, 273, 57 S. Ct. 457, 81 L. Ed. 639 (1937), in discussing the three cases before him, said:

> "In each case, the person originally entitled to receive the certificate directed, for his own convenience

> and purposes, that it be issued in the name of a nominee."

he was referring to cases in which stock was issued at the bequest of the owner in the name of someone with no beneficial interest or claim of beneficial interest, but merely for convenience of the owner (see Discussion of Facts, 300 U. S. 270-272). In one of the lower court opinions, Judge Augustus M. Hand used "nominee" repeatedly to describe the partnership whose sole business was to hold bare legal title to securities for the owner, and which by express contract had no beneficial interest in such securities, and stated that the question was whether the mere nomination of such partnership "as a dummy" was taxable.

> *Founders General Corporation v. Hoey,* 84 F. 2d 976, 977-979 (2nd Cir., 1936).

In *United States v. A. B. Leach & Co.,* 84 F. 2d 908 (7th Cir., 1936), the Seventh Circuit Court described without discussion as "nominee" an employee of a firm of stock brokers in whose name the firm had stock issued for convenience in contemplated sales to the public. The use of the word "nominee" in these cases demonstrates its common and clear usage and meaning.

How restricted a meaning the word "nominee" has in actual practice is shown in the discussion of the word by the Deputy Commissioner of Internal Revenue (Letter 1/10/39 from D. S. Bliss, Deputy Commissioner, P-H Federal Taxes, Permanent Volume, Excise Taxes, Par. 190,307):

> "Reference is made to your letter of December 5, 1938, relating to the distinction between a nominee and a custodian, particularly as the latter term is used

in section 711 of the Revenue Act of 1938 and the regulations relating thereto.

"In reply you are advised that it is the view of this office that the word 'custodian', as used in section 711, signifies a person who has independent possession of securities. This is indicated in the statute by the words 'held or disposed of . . . for . . . the owner', as well as by the requirement of a written agreement between the owner and the custodian. It would appear to be inconsistent for the owner to execute a written agreement respecting the care of securities with a person who did not have independent possession of them. It should be noted, however, that the custodian in such a case is not a 'nominee'. It is not the usual function of a nominee to retain possession of the securities registered in his name. The nominee merely lends his name, and the securities endorsed by him, are held by the owner, or by the custodian. Ordinarily, a nominee is an employee of the owner or custodian, or may be a partnership created solely in order to lend its name for nominee purposes. The ordinary nominee is therefore not a custodian within the meaning of section 711."

"Nominee" has the same restricted meaning in lay circles. Harold McMillan, Prime Minister of England, when addressing a meeting of the Inter-Parliamentary Union in London recently, defined parliamentary government as a representation of "individuals, not ciphers; free men, not nominees."

The New Yorker, Vol. XXXIII, No. 32, Sept. 28, 1957, p. 136 (Letter from London).

Appellants argue that nominee and grantee are synonymous, and that grantee and assignee are synonymous, so that nominee and assignee are the same (A. B. 11). It is true that a nominee, to the extent he receives title, is a grantee, but grantee is a word of great range. A grantee may receive only a bare legal title with no beneficial interest (as a nominee) or full and complete ownership (as an assignee). He is a grantee in both cases because he is the recipient of a grant, but the grant he receives depends on the terms in which it is couched.

V.

The Contract Was Not Assignable.

An agreement is not assignable if by its terms it shows an intent by the offerer to deal only with the person to whom it is made.

> *Arkansas Valley Smelting Co. v. Belden Co.,* 127 U. S. 379, 8 S. Ct. 1308, 32 L. Ed. 246 (1888);
>
> *Portuguese-American Bank v. Welles,* 242 U. S. 7, 37 S. Ct. 3, 61 L. Ed. 116 (1916);
>
> *Wheeling Creek Gas Coal & Coke Co. v. Elder,* 170 Fed. 215, 221-2 (N. D. W. Va., 1909);
>
> *LaRue v. Groezinger,* 84 Cal. 281, 24 Pac. 42 (1890);
>
> *Farmland Irrigation Co. v. Dopplmaier,* 48 Cal. 2d 208, 222, 308 P. 2d 732 (1957).

In *Arkansas Valley Smelting Co. v. Belden Co., supra,* the United States Supreme Court said (127 U. S. 387):

> "But every one has a right to select and determine with whom he will contract, and cannot have another person thrust upon him without his consent. In the familiar phrase of Lord Denman, 'You have

> the right to the benefit you anticipate from the character, credit and substance of the party with whom you contract.' "

In *Portuguese-American Bank v. Welles, supra,* Mr. Justice Holmes said (242 U. S. 11):

> "There is a logical difficulty in putting another man into the relation of the covenantee to the covenantor, *because the facts that give rise to the obligation are true only of the covenantee*—a difficulty that has been met by the fiction of identity of person and in other ways not material here. *Of course a covenantor is not to be held beyond his undertaking and he may make that as narrow as he likes.*" (Italics added.)

In *LaRue v. Groezinger, supra,* the California Supreme Court stated that while the omission of the words "or assignee" from an option did not render the option non-assignable, nevertheless such an option would be non-assignable if (1) the circumstances under which it was made showed that it was not to be assigned, or if (2) the language used showed an intention on the part of the optionee that it was not to be assigned. As to the latter, the Court said (84 Cal. 283-4):

> "Upon the same principle, although a contract may not expressly say that it is not transferable, yet if there are equivalent expressions or *language which excludes the idea of performance by another, it is not assignable.*" (Italics added.)

That this was a personal, non-assignable obligation is shown in the language in which it was couched. It was in a letter addressed to Shaw, and ran to "you, or your nominee" [R. 14]. This personal tone, the omission of

the word assignee and the use of the severely restrictive word "nominee" in its stead, demonstrate that the alleged agreement was not assignable.

The word "nominee" as used in the contract must be given effect. In the case of *Wagner Electric Corp. v. Hydraulic Brake Company,* 12 Fed. Supp. 837 (S. D. Cal., 1935), Wagner contracted to render monthly reports to Hydraulic covering total sales by Wagner "of licensed equipment and parts thereof" and to accompany such reports with payment of royalties specified in the license agreement. Wagner claimed that "parts", when not covered by claims of Hydraulic's patents, were not subject to royalties. Judge McCormick said (12 Fed. Supp. 844):

> "Moreover, if the parties had intended that only patented entities were to be subjected to royalties, they would not have used the words 'and parts thereof'. It would have been sufficient to have used the expression 'licensed equipment'. It is an established principle that in construing writings effect should be given to each and all words used if that can be done reasonably."

Similarly, Section 1641 of the California Civil Code provides:

> "The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."

The offer was an offer to purchase personal notes executed by unspecified individual veterans. These notes must name a specific payee and cannot be bearer notes (see 38 C. F. R. 36.4000(t)). Accordingly, an endorsement is necessary for their negotiation.

The alleged agreement is silent as to what type endorsement the notes were to carry. Even if the endorsement could be "without recourse", such a limited endorser does not rid himself of all liability. He is liable as a warrantor.

Cal. Civ. Code, Sec. 3146;

Quatman v. Superior Court, 64 Cal. App. 203, 208-209, 221 Pac. 666 (1923);

Spiegelman v. Eastman, 95 Cal. App. 205, 212-213, 272 Pac. 761 (1928);

Owens-Parks Lumber Co. v. McCarty, 121 Cal. App. 623, 629, 9 P. 2d 310 (1932).

In either event, whether the endorsement was to have been with or without recourse, the financial ability and personal integrity of the endorser are of paramount importance in an operation of this magnitude. And at least as important is confidence in the business judgment and personal integrity of the seller.

The essential factor in any loan is the credit standing and character of the borrower. Appellee quite obviously from the contract language intended to deal in such matters only with Shaw and not with a stranger.

That the loans are to be real estate loans merely narrows the risk. By the terms of the agreement, the loans must be twenty-nine year loans. Accordingly, valuation of the security involves not only a judgment as to the present value of the real estate securing each note, but a prognostication as to the long range value of that real estate.

Likewise, the requirement that the personal notes be guaranteed by the United States Government does not eliminate the necessity for shrewd judgment of the long

range credit of the veteran-maker, as well as of the real estate security. By law, the guarantee of the United States Government on a veteran's real estate loan is limited to 60 per cent of its value or $7,500, whichever is smaller. 64 Statute 75, Section 301(d); 38 U. S. C. 694a(b). The maximum amount of guarantee possible on $7,500,000 worth of veterans' loans under the statutory formula would be $4,500,000, which would leave at least $3,000,000 unguaranteed, or a larger sum if any loans exceeded $7,500, or were guaranteed before 1950 when the maximum guarantee was smaller.

Necessarily, Appellee, in making the offer, was relying on the personal integrity of Shaw and his judgment both of real estate values and of the financial responsibility of the individual veteran borrowers. Such personal reliance is not an article to be sold and assigned without the consent of the person relying.

It is important to note also that the original letter, Exhibit A, covered both the making and the buying of loans [R. 13-14]. The restrictive word "nominee" is also used as to the making of loans, and the reasons for dealing with a known individual are for obvious reasons even more cogent in these circumstances.

Further proof of the need of the restriction imposed by "nominee" is the fact that the original contract, involving questions of confidence and judgment, was between Los Angeles parties. Now, in derogation of the language of the contract, parties from the other side of the continent seek to intrude themselves.

In other words, this is a contract involving personal skill, trust, and confidence.

The general rule has long been that contracts which involve personal skill, trust, or confidence are not assignable unless expressly made so by their terms.

> *Coykendall v. Jackson,* 17 Cal. App. 2d 729, 731, 62 P. 2d 746 (1936).

VI.

The Meaning of the Word "Nominee" Cannot Be Varied by Parol Evidence.

If the language of a written contract is clear and explicit and does not express an absurdity, it cannot be varied or explained by parol evidence but must speak for itself.

In *Wells Fargo Bank & Union Trust Co. v. McDuffee,* 71 F. 2d 720 (9th Cir., 1934), cert. den. 293 U. S. 626 (1935), this Court refused to permit parol evidence of an alleged agreement excluding foreign bills of lading from a written contract, saying (71 F. 2d 721):

> "Parol evidence can be introduced to identify the subject matter of the contract, but not to contradict its terms. *Gardiner v. McDonogh,* 147 Cal. 313, 81 P. 964. There may be a valid, oral collateral agreement, if it does not conflict with or alter the terms of the written agreement. *Whittier v. Home Savings Bank,* 161 Cal. 311, 317, 119 P. 92; *Dollar v. International Banking Co.,* 13 Cal. App. 331, 109 P. 499. But where the written agreement purports to be complete, terms cannot be added to it by parol. *Empire Inv. Co. v. Mort,* 169 Cal. 732, 147 P. 960."

Pacific States Corporation v. Hall, 166 F. 2d 668 (9th Cir., 1948), involved the interpretation of the words "until paid." The Court said (166 F. 2d 672):

> "The note for the original $45,000 indebtedness provided for the payment of the principal on or before five years after date 'with interest from date until paid.' . . . Appellees contend that 'until paid' should be read as 'until maturity.' With this we cannot agree. The intention of the parties must be gathered from the face of the contract and where, as here, there is an express provision requiring a certain rate of interest until the principal is paid, the contract must be so enforced."

California cases are to the same effect.

Ohio Electric Car Co. v. Le Sage, 182 Cal. 450, 455-456, 188 Pac. 982 (1920);

Dillon v. Sumner, 153 A. C. A. 707, 710 (1957);

El Zarape Tortilla Factory, Inc. v. Plant Food Corp., 90 Cal. App. 2d 336, 344, 203 P. 2d 13 (1949);

Cox v. Miller, 15 Cal. App. 2d 494, 497-498, 59 P. 2d 628 (1936);

Briggs v. Marcus-Lesoine, Inc., 3 Cal. App. 2d 207, 212, 39 P. 2d 442 (1934).

Ohio Electric Car Co. v. Le Sage, supra, involved the interpretation of a written guarantee attached to the contract. The Court said (182 Cal. 455-6):

> "The surrounding circumstances cannot be resorted to for the purpose of giving a different meaning to the terms of the guaranty. There is nothing ambiguous in these terms, nor were any facts alleged which create an intrinsic ambiguity, and in such cases extrinsic evidence to control or explain the meaning of the language is inadmissible."

In *Cox v. Miller, supra,* the Court said (15 Cal. App. 2d 498):

> "The trial court erred in admitting parol evidence to explain the unambiguous terms of a written contract (secs. 1638 and 1639 Civ. Code).
>
> " 'Where the terms of an agreement are set forth in writing and the words are not equivocal or ambiguous, the writing or writings will constitute the contract of the parties, and one party is not permitted to escape from its obligations by showing that he did not intend to do what his words bound him to do.' (*Brant v. California Dairies Inc.,* 4 Cal. 2d 128, 48 Pac. 2d 13.)"

Thus, parol evidence then cannot be introduced to vary the meaning of the language of the alleged written agreement which is definite and clear.

As the cases cited above demonstrate, the meaning of nominee is clear and unambiguous. Appellants in their brief cite no cases interpreting the word otherwise, or as having any special usage.

Appellants argue that, irrespective of the certainty of the meaning of "nominee," they should be permitted to introduce evidence to show trade usage as to the meaning of nominee (A. B. 13, 14). This argument was not raised in the court below, nor is it in "Appellants' Statement of Points Upon Which Appellants Intend to Rely. . . ." [R. 24-26.] Nor is there any allegation whatever of trade usage in either the original Complaint [R. 3-7] or the Amended Complaint [R. 8-13]. Appellants' contention would mean as a practical matter that no complaint sounding in contract could ever be subject to a motion to strike on the basis of the terms of the contract as alleged.

The Supreme Court long ago held in *Grace v. American Central Insurance Company,* 109 U. S. 278, 283, 3 S. Ct. 207, 27 L. Ed. 932 (1883):

> "An express written contract, embodying in clear and positive terms the intention of the parties, cannot be varied by evidence of usage or custom."

See also *Withers v. Moore,* 140 Cal. 591, 597, 74 P. 159 (1903).

In the very recent case of *Lattimore v. Merchants Fire Assurance Corporation,* 151 Fed. Supp. 396, 399 (N. D. Calif., 1957), the District Court in this Circuit held:

> "If a clear, positive and unambiguous contract is executed, then custom, usage or practice cannot be used to vary, enlarge or otherwise alter the terms."

In *Home Insurance Company v. Exchange Lemon Products Co.,* 126 Fed. Supp. 856, 859 (S. D. Calif., 1954), the District Court in this Circuit refused to permit evidence of trade usage to make an insurance policy cover goods in storage when the express words of the contract said the policy covered goods while being transported, "but not if such property is in storage." The court there stated the rule (126 Fed. Supp. 858, 859):

> "If, as alleged in the counterclaim, the agents of the parties knew of and discussed the transit privilege provisions of the applicable railway tariff and the likelihood of storage occurring, the insertion in the contract of the express provision that the policy does not cover 'if such property is in storage' is a clear indication that the parties intended to exclude the application of such usage from their contract. Under such circumstances the law is settled that evidence of trade usage is not admissible. The Cali-

fornia Supreme Court in *Ermolieff v. R. K. O. Radio Pictures, Inc., supra,* citing *New York Central R. Co. v. Frank H. Buck Co.*, 2 Cal. 2d 384, 41 P. 2d 547, states the rule: '* * * where the terms of the contract are expressly and directly contrary to the precise subject matter embraced in the custom or usage, parol evidence of that custom or usage is not admissible.' [19 Cal. 2d 153, 122 P. 2d 6.] Also see *Fish v. Correll,* 4 Cal. App. 521, 88 P. 489; *Withers v. Moore,* 140 Cal. 591, 74 P. 159; Wigmore on Evidence, 3rd Ed., Vol. IX, Sec. 2440, p. 127; Williston on Contracts, Sec. 656; Restatement, Contracts, Sec. 247, comment (d), p. 350. As stated by the United States Supreme Court, 'This rule is based upon the theory that the parties, if aware of any usage or custom relating to the subject-matter of their negotiations, have so expressed their intention as to take the contract out of the operation of any rules established by mere usage or custom.' *Grace v. American Central Ins. Co.,* 109 U. S. 278, 283, 3 S. Ct. 207, 210, 27 L. Ed. 932.

"The language of the contract is unambiguous and is fairly susceptible of but one interpretation. It is denominated a transportation policy and the parties intended it to cover the goods while being transported, 'but not if such property is in storage.' At the time of their destruction and for approximately a year prior thereto, the goods were in storage and, therefore, not covered by the policy."

The contract in the present case is clear and unambiguous. From the contract itself, and the subject matter of the contract, it is apparent that the word "nominee" was used deliberately in its restrictive character.

VII.

This Action Must Fail Because It Is Not Prosecuted in the Name of the Real Party in Interest.

The real party in interest in the present action is Harold L. Shaw, who is not a party to the litigation.

Rule 17(a) of the Federal Rules of Civil Procedure provides:

> "Every action shall be prosecuted in the name of the real party in interest; . . ."

Moore restates the rule (3 *Moore's* Federal Practice, Sec. 17.02, p. 1305):

> "The meaning and object of the real party in interest provision would be more accurately expressed if it read: *An action shall be prosecuted in the name of the party who, by the substantive law, has the right sought to be enforced.*"

The California statute (Code Civ. Proc., Sec. 367) is similar, and reads:

> "Every action must be prosecuted in the name of the real party in interest; . . ."

This rule has been interpreted in the case of *Young v. Garrett,* 149 F. 2d 223 (8th Cir., 1945). The Court in that case held that state law controls as to who are indispensable parties, and ruled that, since under Arkansas law tort claims were not assignable, the attempted assignor was a necessary party. See also note in 4 U. C. L. A., L. Rev. 619, 621-622 (June, 1957).

By substantive law, the right here sought to be enforced is in Harold L. Shaw, who is not even a party.

VIII.

Appellants Are Not Nominees.

Appellants nowhere allege that they are suing on behalf of Shaw, and it is plain from a reading of the Amended Complaint that they are suing in their own right. Further, Appellants nowhere allege that any of their actions have been done on behalf of Shaw. All acts alleged by Appellants are clearly stated as acts of Appellants in their own right. Appellants allege in Paragraph VII of their verified Amended Complaint that [R. 11]:

> ". . . at all times since the said 10th day of November, 1956, the Plaintiffs have been and are the owners and holders of all the right, title and interest of the said Harold L. Shaw in and to the agreement in writing hereinabove set forth."

This allegation is inconsistent with the status of a nominee, who merely acts for or stands in place of the true holder of all right, title, and interest, and is adverse to the rights in contract belonging to Shaw.

The paper, Exhibit B [R. 15], on which Appellants rely to acquire their rights, is also inconsistent with a designation of nominee. This paper obviously is an assignment. It recites a consideration in the very paragraph that purports to be a designation of a nominee. Consideration is not necessary, or usual, to a designation of nominee, but it is common in an assignment and always present in a sale. Finally, the second paragraph of Exhibit B assigns to Appellants "as my nominee' all right, title, and interest of Shaw, a contradiction in terms. It is thus apparent that the instrument, Exhibit B, under which Appellants claim is an assignment, and the use of "nominee" therein is inconsistent with the whole tenor of the paper and ineffective as a designation of nominee.

Further, the language of the letter, Exhibit C [R. 16-17], is that of one who acts as principal and owner in his own right. It states throughout what "we," the Appellants, are doing. "We" nowhere purports to act on behalf of Shaw.

Hence, it is apparent that Exhibit B is a purported assignment and that Appellants have so regarded it in fact and in the allegations of their Complaint.

IX.

It Is Apparent From the Complaint That Appellee Has Not Waived the Non-assignability of the Contract.

The original Complaint contained no allegations of any waiver by Appellee of its right to deal with Shaw or his nominee alone, or of any reliance by Appellants on a waiver [R. 3-7]. In their Amended Complaint, Appellants allege [Par. IX, R. 11]:

> "That, between the said 5th day of December, 1956, and the 8th day of January, 1957, the Defendant recognized, acknowledged and dealt with the Plaintiffs herein as the assignee of Harold L. Shaw, and in reliance thereon Plaintiffs herein changed their position to their detriment and damage as is hereinafter set forth."

The motion to dismiss for failure to state a claim upon which relief can be granted and for failure to join an indispensable party is made under Rule 12 of the Federal Rules of Civil Procedure. Such a motion performs the same function as the old common law general demurrer. It admits for the purpose of the motion only well-pleaded allegations of the complaint which are material and

relevant and not arguments, unwarranted inferences, and legal conclusions.

Flanigan v. Security-First National Bank, 41 Fed. Supp. 77, 79 (S. D. Cal., 1941);

2 *Moore's* Federal Practice (2nd Ed.), Sec. 12.08, p. 2244.

A motion to dismiss does not admit conclusions of law or inference or conclusions of fact not supported by allegations of specific facts upon which the inferences or conclusions rest.

Newport News Co. v. Schauffler, 303 U. S. 54, 57, 58 S. Ct. 466, 82 L. Ed. 646 (1938);

Pacific States Co. v. White, 296 U. S. 176, 184, 185, 56 S. Ct. 159, 80 L. Ed. 138 (1935);

Dunn v. Gazzola, 216 F. 2d 709 (1st Cir., 1954);

Sexton v. Barry, 233 F. 2d 220 (6th Cir., 1956).

Not only is the matter not well pleaded in this Amended Complaint, but the general allegations of the paragraph are contradicted by the specific factual allegations of the Complaint which show that Appellants had entered upon their course of action prior to December 5, 1956, and did not change it then or thereafter.

The Designation of Nominee and Assignment of Commitment of November 15, 1956 [Ex. B, R. 15], three weeks before the beginning of the alleged waiver, and the letter of December 20, 1956 [Ex. C, R. 16-17], two weeks after it, in almost identical language present Appellants' contradictory claims. Hence, there was quite obviously no change of position by Appellants between November 15, 1956 and December 20, 1956.

Both the Amended Complaint [Par. X, R. 11] and Exhibit C [R. 16-17] set December 20, 1956 as the date of Appellants' alleged tender. The letter of tender of December 20, 1956 is in the language of the paper of November 10, 1956, so the tender itself does not represent any change of position, but on the contrary represents a position taken by Appellants before any communication with Appellee.

Paragraph XII of the Amended Complaint [R. 12] alleges that Appellee refused to purchase such loans "and has, at all times since said 20th day of December, 1956, continued to fail and refuse to purchase" the loans. A flat refusal to buy on the date of tender is hardly a basis for estoppel or waiver. There had been no change of position before December 20, 1956, and on December 20, 1956, Appellee rejected Appellants in whatever capacity they were acting.

Finally, as previously argued, the alleged agreement [Ex. A, R. 13-14] ran only to Shaw or his nominee. The allegations of Paragraph IX are an attempt to evade the parol evidence rule and must fail also on the basis of the authorities heretofore cited.

In *Pacific States Corporation v. Hall,* 166 F. 2d 668 (9th Cir., 1948), claim was made that a creditor had waived his claim for interest by failing to include interest on statements issued. The Court said (166 F. 2d 671):

> "Appellees contend that consideration is not always a requisite for waiver, but it is generally held that where substantial rights are involved, a waiver must be supported by a consideration to be valid. 56 Am. Jur. Sec. 16, p. 117. At any rate, waiver consists of a voluntary and intentional relinquishment of a known right; and to prove a case of im-

plied waiver of a legal right, as appellees here attempt to do, there must be a clear, unequivocal and decisive act of the creditor showing a purpose to abandon or waive the legal right, or acts amounting to an estoppel on his part."

None of the foregoing are present in the allegations of the Amended Complaint.

Conclusion.

It is thus apparent that Appellants purported to act and to sue as assignees of a written agreement which is not assignable and hence have no rights in such agreement, that Appellants are not the real parties in interest, and the real party in interest has never acted under the contract or brought suit, and that there has been no waiver or estoppel.

It is respectfully submitted that the judgment dismissing the action should be sustained.

Respectfully submitted,

McKenna & Fitting,

By Paul Fitting,

Attorneys for Appellee, Home Savings and Loan Association.

No. 15,805

United States Court of Appeals

For the Ninth Circuit

MAGNOLIA MOTOR & LOGGING CO., a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

OPENING BRIEF OF APPELLANT, MAGNOLIA MOTOR & LOGGING CO., A CORPORATION.

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No. 15,805

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MAGNOLIA MOTOR & LOGGING CO., a Corporation,	*Appellant,*
VS.	
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OPENING BRIEF OF APPELLANT, MAGNOLIA MOTOR & LOGGING CO., A CORPORATION.

STATEMENT OF JURISDICTION.

This is an appeal from a judgment of conviction of violation of 18 U.S.C.A. Sec. 641 and of 18 U.S.C.A. Sec. 1361, entered by the United States District Court, for the Northern District of California, Northern Division. The appellant gave timely notice of appeal. (TR 26.)

The United States Court of Appeals for the Ninth Circuit, has jurisdiction to review the judgment under the provisions of 28 U.S.C.A. Sec. 1291.

STATEMENT OF THE CASE.

Appellant is a corporation. It, and its President and Managing Officer, R. Drew Lamb, were indicted

under 18 U.S.C.A. Sec. 641 for knowingly, wilfully and unlawfully stealing and converting a quantity of logs of the United States, and under 18 U.S.C.A. Sec. 1361 for knowingly, wilfully and unlawfully depredating certain real property of the United States. (TR 3, 4.)

The appellee's evidence to support these charges was intended to show that at sometime between June 1, 1953 and December 30, 1954, the appellant had logged a quantity of standing timber from an area which was later, on March 30, 1956, officially designated as Township 11½, North, Range 3 East, Humboldt Meridian. (Plaintiff's Exhibits 3 and 6.) All evidence offered against the appellant showed it acted only through its co-defendant, R. Drew Lamb, who was jointly tried with appellant and who was adjudged not guilty.

Township 11½ North is a strip of land lying between Township 12 North and Township 11 North, Range 3 East, Humboldt Meridian.

In 1882, a Government surveyor named Hahn surveyed said Township 11 North. In the same year a Government surveyor named Foreman surveyed said Township 12 North, using the Hahn north boundary of Township 11 as the south boundary of Township 12. In 1883, the plat of the Foreman survey of Township 12 was approved by the United States Surveyor General. In 1884, because of fraudulent survey work, both the Hahn and Foreman surveys were suspended.

In 1886, a resurvey was made of said Township 11 North by a Government surveyor named Gilcrest. In

1889 the Gilcrest survey of Township 11 was officially approved by the Surveyor General. In 1896 the said Foreman survey of Township 12, which previously had been suspended by the Surveyor General, was reinstated. This resulted in the two townships having a common boundary line according to plat.

Between 1901 and 1908, the United States issued patents in certain sections of Townships 11 and 12 North, Range 3 East—H.M. In at least one instance a single patent was issued containing contiguous parcels of land in both townships. (Defendant's Exhibits S 1 and A 1 (marked L 1) Tr. p. 1044, Tr. p. 1032, line 12 to p. 1044, line 22.)

In 1926 a Government surveyor named Joy retraced portions of the Gilcrest North boundary of said Township 11 and apparently found discrepancies which he reported.

In 1950 R. Drew Lamb commenced negotiations for the purchase of a large tract of land in Humboldt County, California, a portion of which is the specific area set forth in the bill of particulars filed by the Government. (TR 17.) On July 15, 1950, a contract of sale was entered into whereby Magnolia Lumber Sales Co., an Oregon partnership, of which Lamb was the managing partner, purchased approximately 10,000 acres of timber land in this area from Arrow Mills Co. Following this, the appellant Magnolia Motor & Logging Co., a corporation, qualified to do business in California and was engaged by the said Magnolia Lumber Sales Co. as an independent contractor to log its timber.

After Magnolia Lumber Sales Co. purchased the property from Arrow Mills Co., and before any logging was done, R. Drew Lamb, President of appellant and Managing Partner of Magnolia Lumber Sales Co., procured the advice of competent legal counsel and thoroughly investigated the findings and opinions of his predecessors in interest of the alleged unsurveyed area, and on the basis of such investigation satisfied himself, as President of appellant, that there was a common line between Township 11 North and 12 North and that no hiatus existed. This was his belief between the 1st day of June, 1953, and the 30th day of December, 1954. (Tr. 1301-1302.)

During 1952, 1953 and 1954, logging operations in the general area were conducted by Magnolia Motor & Logging Co. In 1954, a Government surveyor, Roger F. Wilson, was directed to investigate the condition of the survey to see *if there was a hiatus* between the two townships, and if he found one, to survey it. (Tr. 125, 133.) On March 30, 1956, the Wilson survey plat was filed and approved by the Surveyor General; this plat created Township 11½ and for the first time effected a record hiatus between Townships 11 and 12 which, until that time, had of record enjoyed a common boundary line with no intervening area between them.

The trial court declined on motion to direct a verdict in favor of appellant. (TR 19-22.)

QUESTIONS PRESENTED.

1. Is not the verdict of guilty as to the appellant corporation so inconsistent with the verdict of acquittal of the co-defendant, R. Drew Lamb, that the verdict of appellant must be set aside?

2. Is not the logging and removal of standing timber on unsurveyed land a violation only of the specific provisions of either 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853, rather than a violation of the general provisions of 18 U.S.C.A. 1361?

3. Is not the cutting and removal of standing timber clearly without the provisions of 18 U.S.C.A. 641, but rather a violation of either 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853?

4. Is not a conviction under sections 18 U.S.C.A. 641, and 18 U.S.C.A. 1361, for the specific course of action charged, a violation of due process as protected by the Fifth Amendment to the Constitution of the United States?

5. Does not the acquittal of R. Drew Lamb, the sole acting agent of appellant corporation, affirmatively establish that no crime had been committed by the appellant corporation due to the absence of either specific intent or *mens rea?*

6. Under all the evidence adduced, were not the acts of appellant, based on investigation and on advice of counsel, conduct which was less than wilful and therefore not criminal?

7. Was not the court's instruction to the jury that the land known as Township 11½ North, Range 3

East, Humboldt Base & Meridian, is and *was the property of the United States during the periods of time charged in the indictment* prejudicial error in that it invaded the province of the jury and gave an *ex post facto* application to the survey?

8. Did not the surveys approved and filed in 1889 and 1896 legally identify the contiguous boundary lines of Townships 11 and 12, which boundaries were legally established until Township 11½ was *created* by the filing of the Wilson survey on March 30, 1956, so as to negate any criminal intent on the part of appellant?

SPECIFICATIONS OF ERROR.

1. The District Court erred in denying appellant's motion to dismiss the indictment.

2. The District Court erred in denying appellant's motion for acquittal.

3. The District Court erred in failing to direct a verdict of not guilty.

4. The District Court erred in receiving a verdict of guilty as to appellant.

5. The District Court erred in faling to enter a judgment that appellant was not guilty, notwithstanding the verdict.

6. The District Court exceeded its jurisdiction.

7. The verdict is not supported by substantial evidence.

8. The District Court erred in admitting into evidence plaintiff's Exhibit "3" and plaintiff's Exhibit "6".

Objection was made by appellant on the grounds that the Exhibits were "incompetent, irrelevant and immaterial," (Tr. 6, 10 and Extracts from Reporter's Transcript 6-54.) Exhibit 3 is the official plat of survey of Township 11½ North, Range 3 East, Humboldt Meridian (Admitted Tr. 8.) Exhibit 6 is the tract book record, pages 239-240 of sections 31, 32, 33, 34, 35 and 36, Township 11½ North. (Admitted Tr. 10.)

9. The District Court erred in refusing to admit into evidence defendants' Exhibit H for identification.

Objection was made by the plaintiff on the grounds that the Exhibit was irrelevant. (Tr. 1412.) Exhibit H is a letter addressed to the United States Department of Interior, Federal Land Department by Glen E. Adkisson, containing on the bottom thereof, a reply prepared and initialed by L.D.R. (Laurel D. Reimund) Land Law Clerk, Sacramento office of Bureau of Land Management. (Tr. 83-87, 1171-1176, 1407-1412.) (Denied Admission Tr. 1412.)

10. The District Court erred in giving plaintiff's instruction No. 15. Instruction No. 15 reads as follows:

You are instructed that the land now known as Township 11½ North, Range 3 East, Humboldt Base and Meridian, is and was the property of the United

States during the periods of time charged in the indictment.

Objection was made and exception taken by appellant on the grounds that it was a question of fact to be determined by the jury.

Extracts from Reporter's Transcript 133-140.

I. THE VERDICT OF GUILTY AS TO THE APPELLANT CORPORATION IS INCONSISTENT, IRRATIONAL, AND CANNOT BE RECONCILED WITH THE VERDICT OF ACQUITTAL OF THE DEFENDANT R. DREW LAMB, THE SOLE ACTING OFFICER OF THE CORPORATION DEFENDANT MAGNOLIA MOTOR AND LOGGING COMPANY.

On February 8, 1957, there was commenced in the District Court of the United States for the Northern District of California, Northern Division, an action entitled "United States of America, plaintiff, vs. R. Drew Lamb and Magnolia Motor and Logging Co., a Corporation, defendants". Each of the defendants was charged with the violation of two counts, namely:

Count I.

I. That the defendant, Magnolia Motor and Logging Co., is a corporation organized and existing under the laws of the State of Mississippi; that the defendant, R. Drew Lamb, is the president of said corporation and at all times herein mentioned was acting within the course and scope of his employment as such president.

II. That between the 1st day of June, 1953, and the 30th day of December, 1954, in the County of

Humboldt, in the Northern Division of the Northern District of California, and within the jurisdiction of this court, the defendants hereto did knowingly, wilfully and unlawfully steal and convert to their own use personal property of the United States, said personal property being more particularly described as follows: Approximately 10,300 fir, cedar and hemlock logs of a value of more than $100.

Count II.

I. That the defendant, Magnolia Motor and Logging Co., is a corporation organized and existing under the laws of the State of Mississippi; that the defendant, R. Drew Lamb, is the president of said corporation and at all times herein mentioned was acting within the course and scope of his employment as such president.

II. That between the 1st day of June, 1953, and the 30th day of September, 1954, the defendants hereto did knowingly, wilfully and unlawfully depredate certain property of the United States to wit: Real property in the County of Humboldt, in the Northern Division of the Northern District of California, and within the jurisdiction of this Court, described as follows: Portions of Sections 33 and 34, Township 11½ North, Range 3 East, Humboldt Meridian; that said depredation exceeded the sum of $100. (TR 3-4.)

On June 20, 1957, the jury returned two verdicts. The defendant R. Drew Lamb was found not guilty as to both Counts 1 and 2, and thereafter a judgment

of acquittal was entered as to said defendant Lamb. The defendant, Magnolia Motor and Logging Co., appellant herein, was found guilty as to both Counts 1 and 2, (TR 18) and on September 30, 1957, Judgment of Conviction was entered and appellant ordered to pay a fine of $10,000.00 on each count. (TR 24-25.)

Throughout the entire trial it was uncontradicted that R. Drew Lamb was the sole acting officer and alter ego of the corporation Magnolia Motor and Logging Company. It is manifest from the entire record that it was the intention and purpose of the prosecution to prove that the sole actor and wrongdoer was R. Drew Lamb.

From the government witnesses C. J. Hopkins, W. R. Ritchie and Ray Leonard Wallace, and by cross-examination of defendant Lamb, it was established without contradiction that Lamb was the managing partner of Magnolia Lumber Sales Company, the purchaser of the land in question (Tr. 1322, 1334); he was the president of appellant, Magnolia Motor and Logging Co. (Ptf. Exh. 1; Tr. 1322-1323, 1334); Lamb personally conducted the negotiations on behalf of Magnolia Lumber Sales Company at the time it purchased the land in question from Arrow Mills Co., (plaintiff's exhibit 33, Tr. 1114) and at the time it entered into an option to sell the land to Paragon Plywood Corp. (plaintiff's exh. 25(b) Tr. 629, 543-546, 555) and he returned a $100,000 deposit to Paragon Plywood Corp. and renegotiated a contract for the sale of the logs (plaintiff's exh. 25, Tr. 548, 601, 607); he controlled the area to be cut (Tr. 697-698,

1369, 879); he hired Ritchie and Wallace to cut and remove the timber (Tr. 587, 863, 1369); Lamb visited the premises at least every two weeks and kept in constant touch with his personnel by radio (Tr. 588, 675, 863, 1274, 1294, 1311, 1331); he travelled over the area and directed that "no trespassing" signs be put up (Tr. 770-771, 1277-1278); both Ritchie and Wallace testified that Lamb personally instructed them to log throughout the unsurveyed area (Tr. 672, 870); and Wallace testified that Lamb instructed him to run off the government surveyors as trespassers. (Tr. 680, 874-875.)

At one time in his testimony plaintiff's star witness, Ritchie testified and very aptly put it: "in my opinion, R. Drew Lamb and any one of the Magnolia Companies are one and the same. He does not identify which company he speaks for." (Tr. 713, 745-746.)

Appellant contends that the findings of the jury cannot be reconciled. If one is accepted, the other must be rejected.

The verdict of guilty as to the corporation is stripped of all semblance of logic or reason and does away with the presumption of correctness usually attributed to the verdict of a jury. (*Peveley Dairy Co. v. United States,* 178 Fed. 2d 363, 370-371.)

As is stated in the *Peveley Dairy Co.* case:

> "The appellants here are corporations. They could act only through officers and agents, yet the only officers and agents who could possibly have committed the violations charged were acquitted. It is true the question on review is not

> whether the verdict of acquittal of the individual defendants was warranted, but whether the verdict of guilty as against the corporations is sustained by substantial evidence, and mere inconsistency in verdicts is not fatal. However, the verdict of not guilty as to the individual defendants in this case certainly stripped the verdict of guilty as to the corporation defendants of all semblance of logic or reason, and to our minds weakened the presumption of correctness usually attributable to the verdict of a jury."

The reviewing court must be extraordinarily careful to scrutinize the record to ascertain any prejudicial error. (*Manley v. United States,* 238 Fed. 2d 221.)

Appellant respectfully contends that the record herein contains such other prejudicial errors, as will hereinafter be set forth, as to compel this court, under the language of the *Peveley Dairy Company* and *Manley* cases, to set aside and reverse the verdict of guilty.

II. THE TRIAL COURT WAS IN ERROR IN DENYING DEFENDANTS' MOTION TO DISMISS THE INDICTMENTS CHARGING VIOLATIONS OF TITLE 18 U.S.C.A. 641 AND 18 U.S.C.A. 1361.

A. The logging and removal of standing timber on unsurveyed land is a violation of the specific provisions of either Title 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853, misdemeanor statutes, rather than a violation of the general felony and depredation provisions of Title 18 U.S.C.A. 641 and 18 U.S.C.A. 1361.

The proper statutory provision under which the defendants should have been charged, if any, was either Title 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853,

both of which are misdemeanor sections and deal specifically with the course of action under consideration by the trial court.

The applicable language of section 18 U.S.C.A. 1852 reads as follows:

> "Whoever cuts, or wantonly destroys any timber growing on the public lands of the United States; or Whoever removes any timber from said public lands, with intent to export or to dispose of the same; or . . . Shall be fined not more than $1,000 or imprisoned not more than one year, or both."

The applicable language of section 18 U.S.C.A. 1853 reads as follows:

> "Whoever, unlawfully cuts, or wantonly injures or destroys any tree growing, standing, or being upon any land of the United States . . . shall be fined not more than $1,000, or imprisoned not more than one year, or both."

The applicable language of section 18 U.S.C.A. 641 reads as follows:

> "Whoever embezzles, steals, purloins, or knowingly converts to his use or the use of another, or without authority, sells, conveys or disposes of any record, voucher, money, or thing of value of the United States. . . . Shall be fined not more than $10,000, or imprisoned not more than ten years, or both; but if the value of such property does not exceed the sum of $100, he shall be fined not more than $1,000 or imprisoned not more than one year, or both."

The applicable language of section 18 U.S.C.A. 1361 reads as follows:

> "Whoever, willfully injures or commits any depredation against any property of the United States. . . . If the damage to such property exceeds the sum of $100, by a fine of not more than $10,000, or imprisonment for not more than ten years, or both; if the damage to such property does not exceed the sum of $100, by a fine of not more than $1,000 or by imprisonment for not more than one year, or both."

A comparison of the above statutes, and a reading of the entire transcript, will make it readily apparent that the case presented by the government was based on alleged violations of sections 18 U.S.C.A. 1852 and 1853, namely the specific acts of cutting, removing or injuring timber or trees growing, standing or being on any public land of the United States and the government attempted to use the general felony sections under which appellant was tried to apply a harsher and more severe degree of penalty for a course of action intended by Congress to be punishable as a misdemeanor under the specific provisions of sections 18 U.S.C.A. 1852 and 1853.

Judge Halbert in his Memorandum and Order dated March 18, 1957, (TR 6-12) set forth the law accurately when he said:

> "It is a well established rule of construction that where two statutory provisions apply to the same set of facts, one applying only to a specific fact situation, and the other applying generally to all similar fact situations, the specific provisions will control the general (*U.S. v. Chase,* 135 U.S. 255; *Ginsbury and Sons v. Popkin,* 285 U.S. 204; *McEvoy v. U.S.,* 322 U.S. 102), and in the con-

> text of a criminal prosecution, the specific provision alone will be applicable (*Price v. U.S.,* 74 Fed 2d 120, and *Robinson v. U.S.,* supra, 142 Fed 2d 433)."

From the earliest federal cases involving the cutting of standing timber on government land, the indictments have been charged under sections similar to Title 18 U.S.C.A. 1852 and 1853. See *Bligh v. U.S.,* 3 Fed. Cases 1581; *U.S. v. Darton,* 25 Fed. Cases 14919; *Teller v. U.S.,* 113 Fed. 273; *Shiver v. U.S.,* 159 U.S. 491.

The Honorable James Alger Fee, in the case *United States v. Frank J. Simpson,* U.S. District Court, District of Oregon No. C-17903, in ruling on a motion to dismiss the indictment brought in said case, indicting the said Frank J. Simpson for violation of Title 18 U.S.C.A. Sections 641 and 1361, with "unlawfully, wilfully, feloniously, and knowingly, embezzling, stealing, purloining and converting to his own use a quantity of standing timber in excess of $100.00 located on lands owned by the United States," resubmitted the indictment to the Grand Jury on the basis that it was not brought under Title 18 U.S.C.A., Sections 1852 and 1853. At one point he stated:

> "And where there is a specific statute which talks about cutting trees, wilfully injuring trees, then I think you have to go under that statute."

B. The cutting and removal of standing timber is not a violation of 18 U.S.C.A. 641 which applies only to the stealing or conversion of personalty belonging to the United States.

It is fundamental, as stated by Judge Halbert in *United States v. Lamb,* 150 Fed. Supp. 310, that standing timber is classified as realty (*United States v. Shoshone Tribe of Indians,* 304 U.S. 111 and *Capoeman v. United States,* 110 Fed. Supp. 924) hence Sec. 641 (relating to personalty) could not be applied.

The entire record is devoid of proof that any personal property of the United States was stolen or converted.

Therefore, the government has failed in its proof and the verdict of guilty must be set aside. The proof, at most, showed acts of cutting, destroying or removing timber on public lands of the United States, misdemeanors prohibited by Sections 18 U.S.C.A. 1852 and 1853, and the court exceeded its jurisdiction in entering the judgment of conviction on Count I.

C. The conviction of appellant under an indictment charging violations of sections 18 U.S.C.A. 641 and 1361, for the specific course of action which is prohibited by sections 18 U.S.C.A. 1852 and 1853, is a violation of the Fifth Amendment to the Constitution of the United States.

It is a violation of due process as protected by the 5th amendment to the Constitution of the United States to charge and convict under a specific set of facts, the violation of which is either a misdemeanor or a felony, and the choice of the statute used to bring in an indictment is left to the whim of the prosecuting authorities. There cannot be different degrees of pen-

alty for different persons for the same criminal act —this is a violation of the equal protection clause of the Constitution. (*Green v. United States,* 236 Fed. 2d 708, 712.)

Mr. Justice Black, in his dissent (in which Mr. Justice Douglas joins) in the case of *Berra v. United States,* 351 U.S. 131, at pages 137 to 140, ably expresses the position appellant contends is applicable in this case, when he says:

> "Since I think petitioner is right in saying the offense charged was only a misdemeanor, I think we should correct the plain error of the trial judge in sentencing petitioner under the felony statute.
>
> The Government admits here and the Court assumes that filing a false and fraudulent income tax return is both a misdemeanor under §3616(a) and a felony under §145(b). The Government argues that the action of the trial judge must be upheld because 'the Government may choose to invoke either applicable law,' and 'the prosecution may be for a felony even though the Government could have elected to prosecute for a misdemeanor.' Election by the Government of course means election by a prosecuting attorney or the Attorney General. I object to any such interpretation of §§145 and 3616. I think we should construe these sections so as not to place control over the liberty of citizens in the unreviewable discretion of one individual—a result which seems to me to be wholly incompatible with our system of justice. Since Congress has specifically made the conduct charged in the indictment a misdemeanor, I would not permit pros-

ecution for a felony under the broad language of §145(b). Criminal statutes, which forfeit life, liberty or property, should be construed narrowly, not broadly. . . . '. . . The Government's whole argument rests on the stark premise that Congress has left to the district attorney or the Attorney General the power to say whether the judge and jury must punish identical conduct as a felony or as a misdemeanor.

A basic principle of our criminal law is that the Government only prosecutes people for crimes under statutes passed by Congress which fairly and clearly define the conduct made criminal and the punishment which can be administered. This basic principle is flouted if either of these statutes can be selected as the controlling law at the whim of the prosecuting attorney or the Attorney General. 'For, the very idea that one man may be compelled to hold his life, or the means of living or any material right essential to the enjoyment of life, at the mere will of another, seems to be intolerable in any country where freedom prevails, as being the essence of slavery itself.'

Yick Wo v. Hopkins, 118 U.S. 356, 370.

Black J., dissenting.

A congressional delegation of such vast power to the prosecuting department would raise serious constitutional questions. Of course it is true that under our system Congress may vest the judge and jury with broad power to say how much punishment shall be imposed for a particular offense. But it is quite different to vest such powers in a prosecuting attorney. A judge and jury act under procedural rules carefully prescribed to protect the liberty of the individual. Their judgments and verdicts are reached after

a public trial in which a defendant has the right to be represented by an attorney. No such protections are thrown around decisions by a prosecuting attorney. Substitution of the prosecutor's caprice for the adjudicatory process is an action I am not willing to attribute to Congress in the absence of clear command. Our system of justice rests on the conception of impersonality in the criminal law. This great protection to freedom is lost if the Government is right in its contention here. See dissenting opinion in *Rosenberg v. United States,* 346 U.S. 273, 306.

The Government's contention here also challenges our concept that all people must be treated alike under the law. This principle means that no different or higher punishment should be imposed upon one than upon another if the offense and the circumstances are the same. It is true that there may be differences due to different appraisals given the circumstances of different cases by different judges and juries. But in these cases the discretion in regard to conviction and punishment for crime is exercised by the judge and jury in their constitutional capacities in the administration of justice."

Assuming for the sake of argument that timber belonging to the United States was logged and removed by appellant, such acts would amount to a violation of Title 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853 only. Since the evidence at most shows a misdemeanor, and one for which appellant had not been charged, the District Court was without power to receive a verdict of guilty or to render a judgment of conviction of a felony.

III. THE VERDICT AND JUDGMENT OF GUILTY AS TO THE APPELLANT ARE NOT SUPPORTED BY THE EVIDENCE.

A. The acquittal of R. Drew Lamb, the sole acting agent of appellant corporation affirmatively established that no crime had been committed by appellant due to the absence of either specific intent or mens rea.

Intent is a necessary and vital element to be alleged and proved by substantial evidence. (*Morissette v. United States,* 342 U.S. 246; *United States v. Lamb,* 150 Fed. Supp. 310; *Screws v. United States,* 325 U.S. 91; *Teller v. United States,* 113 Fed. 273.)

Before a man can be punished his case must be plainly and unmistakably within the statute. (*United States v. Lacher,* 134 U.S. 624, 628.) There is a presumption that the law has been obeyed.

A corporation cannot have an independent intent. It is a mere creature of its individual officers. (*Peveley Dairy Co. v. United States,* supra.) In the present case the evidence clearly shows that R. Drew Lamb was the sole acting officer and manager of appellant Magnolia Motor and Logging Co., a corporation. The intent of the corporation would of necessity have to be that of defendant Lamb.

By the acquittal of co-defendant Lamb, the jury must have found that he had no specific criminal intent—a necessary element of the crimes charged. (*United States v. Lamb,* supra.) In the face of this finding there can be no conviction of appellant corporation. There is no proof of any independent intent on the part of the appellant and certainly no proof of a *mens rea.* Here both the defendant Lamb and appellant were tried under identical facts, identical charges and identical indictments. (TR 3-4.)

B. Under all the evidence adduced, the acts of appellant, based on the investigation made and advice of counsel, revealed conduct which was less than wilful and therefore not criminal.

Before there can be a conviction, it must be found there existed in appellant a wilful and wrongful purpose to steal and/or depredate property of the United States. There can be no crime without a *mens rea,* and no crime as charged without a specific intent. It must be proved that an officer of the appellant corporation caused the lands of the United States to be entered upon and depredated knowing the same to be a part of the public domain.

Negligence is not the same as wilful violation of the law. In fact, a defendant's ignorance of something which he might have discovered, had he exercised a certain degree of care, is less than wilful. (*Trustees, Dartmouth College v. International Paper Company,* 132 Fed. 92, 98; *United States v. McKee,* 128 Fed. 1002; *United States v. Eccles,* 111 Fed. 490.)

In an earlier case involving a violation of Title 18 U.S.C.A. 1852, the court held that a defendant may rebut a showing of wilful violation by presenting evidence of circumstances of ignorance as to the section lines. (*United States v. Darton,* 25 Fed. Cases 14919.)

In the case of *United States v. McKee,* supra, the court found that there was no wilful trespass where bark was taken from trees on public domain by reason of defendant's misapprehension of the true location of a township boundary line, where three prior surveys had erroneously located the line.

In the instant case, the record stands uncontradicted that Lamb, President of appellant and Managing Partner of Magnolia Lumber Sales Co. after the purchase of the property from Arrow Mills Co., but before any logging was done, (Tr. 952, lines 8-12) Mr. William Briggs, Attorney at Law, Ashland, Oregon, who was attorney for R. Drew Lamb, Magnolia Lumber Sales Co., and appellant Magnolia Motor and Logging Co., phoned the land office in San Francisco and discussed the alleged hiatus with Mr. Carl S. Swanholm and was advised: "Mr. Briggs, there is no gap, according to our records they do join." (Tr. 917-918.) Thereafter, Mr. Briggs phoned the Bureau of Land Management office in Sacramento and was advised ". . . that their plats showed no gap and they also confirmed the fact that the government . . . couldn't lay any claim to it because the gap doesn't exist." (Tr. 919.) Thereafter, Mr. Briggs reported this information to Mr. R. Drew Lamb. (Tr. 924-925.) In addition, Mr. Briggs contacted Belcher Abstract and Title Company of Eureka, California, which would not insure title to the "unsurveyed strip" although they didn't think there was anything to worry about. (Tr. 945, lines 21-24; 962, lines 16-25.) Mr. Briggs informed Mr. Lamb that the information he had was that the corners were together and that they (Government) said there was no gap. (Tr. 948-949.)

Arrow Mills Company, the prior owners of the real property logged in the area in question, and in fact, reserved a portion of the timber when they sold the property involved to Magnolia Lumber Sales Co. (Tr. 935-936, 949, 956, 962, 1126-1127.) At the time of the

negotiations leading to the purchase of the real property from Arrow Mills Company by Magnolia Lumber Sales Co., Mr. Harry B. Jameson, President of Arrow Mills Company informed Mr. R. Drew Lamb that Mr. Jameson and Mr. Clare Shumate on or about October 26, 1949, went to the office of the Bureau of Land Management in Glendale, California and spoke to Mr. Paul Witmer, the gentleman in charge of that office. (Tr. 1116-1121, 1126.) Mr. Witmer saw that Arrow Mills was the owner of the land on both sides of the so-called unsurveyed strip and said ". . . obviously, it either belongs to one side or the other, and if you own both sides, it is yours. . . ." (Tr. 1123.)

Sidney Ainsworth, Attorney at Law, Ashland, Oregon, as attorney for the two defendants, went to Sacramento to search the United States records, and a search revealed that according to the official records, no hiatus existed, and a map in the Bureau of Land Management office in Sacramento did not show the existence of a hiatus. (Tr. 1179, 1205, 1208-1210, 1222, 1226.) This information was reported to the defendant, R. Drew Lamb. (Tr. 1214.)

The defendant, R. Drew Lamb, discussed the purported hiatus with his attorney, Mr. William Briggs and Mr. Briggs' opinion was that the hiatus was a "myth" and there was nothing to it. (Tr. 1267-1268.) In addition thereto, Mr. Lamb discussed the hiatus with Mr. Jameson, the President of the Arrow Mills Co. discussed the matter with Sidney Ainsworth, Attorney at Law, and further discussed the matter with Mr. Hopkins of Paragon Plywood and their attor-

neys, Mr. Wilson and Mr. Chamberlain, Port Angeles, Washington. (Tr. 1269-1270, 1300.) He also was shown a letter dated October 1, 1951, addressed to Hammond, Jenson and Wallen, Mapping and Forestry Services, from Carl S. Swanholm, Regional Chief, Division of Cadastral Engineering, Bureau of Land Management, United States Department of Interior, which states in part: "The official record of survey in Townships 11 and 12 North, Range 3 East, Humboldt Meridian, California, does not reveal the existence of any hiatus, or unsurveyed land between these two townships. As this alleged hiatus is officially non-existent no sales, rights, grants or transfers can be executed therein. . . . Title to unsurveyed lands will vest in the United States." (Plaintiff's Exhibit 29; Defendant's Exhibit U; Tr. 621-622, 1270.)

As a result of the above, R. Drew Lamb formed a belief that the lands in question belonged to Magnolia Lumber Sales Co. and that there was a common line between the two townships and that no hiatus existed and so believed between the 1st day of June, 1953 and the 30th day of December, 1954. (Tr. 1301-1302.)

It is uncontradicted that R. Drew Lamb, as President of Appellant, acted upon the advice of competent counsel.

While, in itself, reliance on advice of counsel is not a defense to a criminal act, it is strong evidence to rebut specific criminal intent. *United States v. Homestake Min. Co.,* 117 Fed. 481, *United States v. Midway Northern Oil Co.,* 232 Fed. 619, 632, *United States v. St. Anthony R. R. Co.,* 192 U.S. 524, 542-543.)

In *United States v. Homestake Min. Co.,* supra, p. 486, the court states:

> "The test to determine whether one was a wilful or an innocent trespasser is not his violation of the law in the light of the maxim that every man knows the law, but his *honest belief,* and his actual intention at the time he committed the trespass; and *neither a justification* of the acts nor any other complete defense to them is essential to the proof that he who committed them was not a wilful trespasser. (cases cited.)
>
> "The fact that one acted on the advice of reputable counsel is persuasive evidence of his good faith. And one who honestly follows the erroneous advice of such counsel upon questions of legal right concerning which a layman would hardly have actual knowledge is not chargeable with bad faith, or with the wilful intent to commit a wrongful act, because his counsel was mistaken in his view of the law."

See also *United States v. St. Anthony R. R. Co.,* wherein, at pages 542-543, the court, in reversing conviction of defendant, says:

> "It was done upon the advice of counsel, and the defendant used ordinary care and prudence in first being advised as to the law and upon the facts as they had been agreed upon, and there was no intention on the part of the defendant to violate any law or to do any wrongful act."

Further, appellant contends that any logging in the disputed area was open and notorious, with no effort to conceal the activities being carried on. This

raises a strong presumption that there was no felonious intent.

This strong presumption of innocence can only be repelled by clear and convincing evidence of a specific criminal intent before a conviction is authorized. *Morissette v. United States,* 342 U.S. 246, 275, *Kemp v. State,* 146 Florida 101, 104, 200 So. 368, 369.

When this presumption of innocence is considered with the overwhelming proof of the formation of an honest belief through a thorough investigation, reliance on advice of those charged with the management and control of Federal public lands and upon the advice of competent counsel, it becomes the duty of the court to find that the plaintiff has failed to sustain its burden of proof of specific intent and *mens rea* and the judgment must be reversed. *Wesson v. United States,* 172 Florida 931, 934.

C. The Court, in instructing the jury that the land now known as Township 11½ North, Range 3 East, Humboldt Base and Meridian, is and was the property of the United States during the periods of time charged in the indictment, committed prejudicial error because it invaded the province of the jury by giving an ex post facto application to the statutes under which appellant was charged.

The court gave the jury the following instruction:

> "You are instructed that the land now known as Township 11½ North, Range 3 East, Humboldt Base and Meridian, is and was the property of the United States during the periods of time charged in the indictment."

Appellant contends this was prejudicial error. The court invaded the province of the jury by taking from

it a determination of a question of fact. Not only was the court in error in charging that the United States owned the land now known as Township 11½ prior to March 30, 1956, because Township 11½ North did not come into existence until that date, but, in any event, the question of ownership of the property allegedly stolen or depredated was a material issue of fact to be proved by the government.

In addition to the foregoing, the court in this charge gave an *ex post facto* or retroactive application to an administrative act which made a course of conduct which was innocent when done, criminal, and punished such action. (11 Am. Jur. #348(b), p. 1176.)

There can be no conviction of theft of government property until it is shown that the property was that of the United States. (*Coacher v. United States,* 256 Fed. 525.) The ownership of the property is an essential element to be charged and proved. (*Morissette v. United States,* 342 U.S. 246.)

A survey of public land does not ascertain the boundaries of the land. It creates them. (*Cox v. Hart,* 260 U.S. 427, 436; *United States v. Northern Pacific Railway Co.,* 311 U.S. 317, 344; *Robinson v. Forrest,* 29 Cal. 317, 325; *Sawyer v. Gray,* 205 Fed. 160, 163.)

A survey is not complete until it receives the approval of the Commissioner and is filed in the District. (*United States v. Morrison,* 240 U.S. 192, 212.)

The chronology of this case is interesting and of extreme importance in pointing up the prejudicial

effect of the retroactive application of the survey which *created* Township 11½ North, Range 3 East, Humboldt Meridian.

The indictment filed February 8, 1957, charges violations of the law between the first day of June, 1953, and the 30th day of December, 1954, in that the appellant knowingly, wilfully, and unlawfully did steal and convert and depredate certain property of the United States upon real property which is described, "portions of Sections 33 and 34, Township 11½ North, Range 3 East." (TR 4.)

There is no dispute that the Wilson survey determining the existence of Township 11½ North was not filed in the District Office, Division of Land Management, Sacramento, California, until March 30, 1956, almost one and one-half years after the last date charged in the indictment.

From 1850, when California was admitted into the Union, until March 30, 1956, the acts charged could not be the basis of a criminal action because Township 11½ was non-existent legally.

The Honorable Trial Judge emasculated appellant's defense when he reversed his position taken at the time of settlement of jury instructions not to give the government instruction No. 15, as set forth above, and took the question of ownership of the property allegedly stolen and depredated from the jury. (Extracts from Reporter's Tr. 133-140.) It is a well established rule of law that the jury alone is to determine question of fact.

D. The surveys approved and filed in 1889 and 1896 legally identified the contiguous boundary lines of Townships 11 and 12, which boundary was legally established until Township 11½ was created by the filing of the Wilson survey, March 30, 1956, so as to negative any criminal intent on the part of appellant.

Township 11½ North is a strip of land lying between Township 12 North and Township 11 North, Range 3 East, Humboldt Meridian.

In 1882, a Government surveyor named Hahn surveyed said Township 11 North. In the same year a Government surveyor named Foreman surveyed said Township 12 North, using the Hahn north boundary of Township 11 as the south boundary of Township 12. In 1883, the plat of the Foreman survey of Township 12 was approved by the United States Surveyor General. In 1884, because of fraudulent survey work, both the Hahn and Foreman surveys were suspended.

In 1886, a resurvey was made of said Township 11 North by a Government surveyor named Gilcrest. In 1889 the Gilcrest survey of Township 11 was officially approved by the Surveyor General. In 1896 the said Foreman survey of Township 12, which previously had been suspended by the Surveyor General, was reinstated. This resulted in the two townships having a common boundary line according to plat.

Between 1901 and 1908, the United States issued patents in certain sections of Townships 11 and 12 North, Range 3 East-H.M. In at least one instance a single patent was issued containing contiguous parcels of land in both townships. (Defendant's Exhibits

S 1 and A 1 (Marked L 1) Tr. p. 1044, Tr. p. 1032, line 12 to p. 1044, line 22.)

In 1926 a Government surveyor named Joy retraced portions of the Gilcrest North boundary of said Township 11.

In 1954, a Government surveyor, Roger F. Wilson, was directed to investigate the condition of the survey to see *if there was a hiatus* between the two townships, and if he found one, to survey it. (Tr. 125, 133.) On March 30, 1956, the Wilson survey plat was filed and approved by the Surveyor General; this plat created Township 11½ and for the first time effected a record hiatus between Townships 11 and 12 which, until that time, had of record enjoyed a common boundary line with no intervening area between them.

As has been stated above, there can be no conviction of larceny without proof of specific intent, nor can there be a conviction of any offense without a proof of *mens rea*. When, as in this case, the evidence shows undisputedly that the United States was forced to make new boundaries in order to assert any claim to the land in question, it necessarily followed that in relying on the boundaries as they existed in 1953 and 1954, appellant could not have entertained either a specific intent to steal property of the United States, nor a specific intent to depredate property of the United States, nor in fact an intent to commit any crime.

The appellant had only an intent to deal with property it believed it was authorized to utilize. To hold

the appellant to a standard of knowledge superior to that held by the officers and agents of the United States who are charged with the responsibility of creating and maintaining the boundaries of public lands, does not accord with the concept of ordinary justice and due process that underlies our laws. It amounts to assessing a penalty for inability to prophesy that a Government Bureau will at a later date repudiate its own official action and adopt an entirely new course of conduct. Since a survey of public land does not ascertain the boundaries of the land, but rather creates them, to convict the appellant of a violation of boundaries that did not exist at the time of the act, is to render the statutes under which the appellant was convicted *ex post facto* in their operation. Had the old boundaries not been abandoned and new boundaries created on March 30, 1956, there could be no charge that the appellant had invaded and depredated public lands of the United States.

The government is the same as any ordinary proprietor of land, (*United States v. West,* 232 Fed. 2d 694.) Rights acquired under a patent may not be affected by subsequent corrective surveys. (*Green v. United States,* 274 Fed. 145; *United States v. State Investment Company,* 264 U.S. 206.)

Land once entered ceases to be public land until there is a cancellation. It then becomes within the category of public land in reference to future acts and is to be dealt with subsequently in the same manner as any other public lands of the United States. (*Barden v. Northern Pacific Railroad,* 145 U.S. 535.)

In the instant case, during the years 1901 and 1908, a substantial portion of the area in Townships 11 North and 12 North, Range 3 East, were patented. These patents were issued following the Gilcrest and Foreman surveys, and prior to the 1926 survey of Joy, wherein the first inkling of a possible hiatus came to light.

In fact, in 1950, the defendant R. Drew Lamb acquired property in the area in question through a Deed which conveyed to him a parcel of real property lying in both Township 11 North and Township 12 North, with no indication that it was other than one contiguous parcel of land. (Def. Exh. S 1, Tr. 1032-1044.)

By the testimony of one of the primary witnesses of the prosecution, Roger F. Wilson, the surveyor who established the boundaries and created Township 11½ North, it is made abundantly clear that during the time in question even the government did not know whether or not a hiatus existed. At page 133 of the transcript he is quoted as saying: "To investigate the conditions of the survey and if a hiatus was discovered, to survey it."

We are dealing here with a paradox. The appellant has been held to have formed a specific intent to enter upon public lands of the United States and steal property of the United States when the United States government did not know whether or not there was a hiatus and the government, in fact, did not know it owned the land and timber. How can the appellant

be found to have possessed a knowledge of public lands superior to that possessed by the government?

Again, how can the appellant corporation be held to have a specific intent to enter upon public lands and steal property of the United States when the jury has acquitted the sole acting officer and agent of the corporation?

Further, the Honorable Trial Court committed prejudicial error in sustaining a government objection to the admission into evidence of a letter written by a responsible agent of the governmental body charged with administering the public lands of the United States which again admits that there was no official knowledge of the alleged hiatus. (Def. Ex. H, Tr. 1412.)

This is a criminal action designed to punish a defendant for the violation of Federal statutes wherein specific intent is a vital element. It is incumbent upon the court to admit into evidence any matter which is relevant in proving a lack of such criminal intent.

Appellant did not attempt to have this exhibit admitted for the truth of its contents, but rather to corroborate the prior testimony of defense witnesses Briggs, Jameson and Ainsworth, and the defendant R. Drew Lamb, by showing the lack of knowledge of the existence of a hiatus on the part of the government prior to and during the times charged in the indictment.

Without the court's instruction No. 15, that the property in question was that of the United States

during the periods of time charged in the indictment, the jury could well have found either that the government, in issuing the early patents based on the common line set out in the Gilcrest survey, intended to dispose of all the lands which eventually came into defendant Lamb's ownership contained in Township 11 North and 12 North, including the land which was subsequently determined to be Township 11½ North, (*Greene v. United States,* 274 Fed. 145), or that the cutting of timber by appellant was based on a good faith belief that it owned the real property and timber in question and had a right to enter upon and cut the timber. (*United States v. Van Winkle,* 113 Fed. 903.) At the very least, this determination should have been decided by the jury.

CONCLUSION.

As has been pointed out, there are errors in this record in the instructions and certain rulings on the evidence, errors that resulted in a deprivation of appellant's defense. But even without said errors, merely to consider the cumulative effect of this record: i.e., that appellant corporation acted solely through its president, R. Drew Lamb, who in turn acted on the advice of counsel, who in turn rendered opinions based upon representations of the government that no hiatus existed, which evidence resulted in an acquittal of said president in the identical case based on identical facts, and identical charges, forces one reading said record without bias or prejudice, and in the exer-

cise of a fair and impartial judgment upon it, to reach the conclusion that appellant corporation acted in every instance in the honest belief that it was lawfully exercising a right which it had lawfully acquired and was, therefore, free of any criminal intent.

We respectfully request the judgment be reversed.

Dated, August 11, 1958.

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No. 15,805

United States Court of Appeals

For the Ninth Circuit

MAGNOLIA MOTOR & LOGGING CO.,
a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF FOR APPELLEE.

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No. 15,805

United States Court of Appeals

For the Ninth Circuit

MAGNOLIA MOTOR & LOGGING CO., a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF FOR APPELLEE.

JURISDICTION.

Jurisdiction is invoked under Sections 641 and 1361 of Title 18, United States Code, and Sections 1291 and 1294 (1) of Title 28, United States Code.

STATEMENT OF FACTS.

1. Evidence offered at the trial proved that the corporation acted through other agents as well as co-defendant, R. Drew Lamb.

2. Township 11 North and Township 12 North, Range 3 East, Humboldt Base and Meridian did not have a common boundary line according to the official records of the Bureau of Land Management.

STATUTES.

18 U.S.C. 641:

> "Whoever embezzles, steals, purloins, or knowingly converts to his own use or the use of another, or without authority, sells, conveys or disposes of any record, voucher, money, or thing of value of the United States . . . shall be fined not more than $10,000, or imprisoned not more than ten years, or both; but if the value of such property does not exceed the sum of $100, he shall be fined not more than $1,000, or imprisoned not more than one year, or both."

18 U.S.C. 1361:

> "Whoever wilfully injures or commits any depredation against any property of the United States, or of any department or agency thereof . . . If the damage to such property exceeds the sum of $100, by a fine of not more than $10,000, or imprisonment for not more than ten years or both; if the damage to such property does not exceed the sum of $100, by a fine of not more than $1,000 or by imprisonment for not more than one year, or both."

QUESTIONS PRESENTED.

1. Is the conviction of the corporation consistent with the evidence?

2. Did the District Court err in denying defendants' Motion to Dismiss the Indictment charging violations of Title 18, United States Code, Sections 641 and 1361?

3. Was the conviction of the appellant under the Indictment charging violations of Title 18, United States Code, Sections 641 and 1361, a violation of the Fifth Amendment to the Constitution of the United States?

4. Are the verdict and judgment supported by the evidence?

5. Was the District Court's instruction that the land now known as Township 11½ North, Range 3 East, Humboldt Base and Meridian, is and was the property of the United States during the periods of time charged in the Indictment proper?

SUMMARY OF ARGUMENT.

I. The Conviction of the Corporation Is Consistent With the Evidence.

The record and the law abundantly support the conviction of appellant.

II. The District Court Was Not in Error in Denying Defendants' Motion to Dismiss the Indictment Charging Violations of Title 18, United States Code, Sections 641 and 1361.

The District Court's opinion in *United States v. Lamb,* (D.C.N.D., Cal. N.D., 1957) 150 F. Supp. 310, properly disposed of this issue.

III. The Conviction of the Appellant Under the Indictment Charging Violations of Title 18, United States Code, Sections 641 and 1361, Is Not a Viola-

tion of the Fifth Amendment to the Constitution of the United States.

There is no real issue of deprivation of due process under the Constitution.

IV. The Verdict and Judgment Are Supported by the Evidence.

A corporation can be convicted of the crimes charged. The evidence shows that the corporation had the necessary criminal intent.

V. The District Court's Instruction That the Land Now Known as Township 11½ North, Range 3 East, Humboldt Base and Meridian, Is and Was the Property of the United States During the Periods of Time Charged in the Indictment Was Proper.

There is no real issue of violation of the *ex post facto* prohibitions of the Constitution of the United States. The District Court properly took judicial notice of the government's ownership of the unsurveyed area. The appellant waived its right to object to the instruction by not exercising that right at the prescribed time.

I.

THE CONVICTION OF THE CORPORATION IS CONSISTENT WITH THE EVIDENCE.

The contention of the appellant herein is that there is gross inconsistency between the conviction of the corporation and the acquittal of the co-defendant, R. Drew Lamb, on the basis that R. Drew Lamb was the sole acting officer and/or agent of the corporation,

Magnolia Motor and Logging Company. The issue, therefore, is whether or not under the law of the land the conviction of the corporation is consistent with the evidence.

That the conviction of the corporation is proper is indicated by the opinion of District Judge Hulen in *United States v. St. Louis Dairy Co., et al.,* (D.C.E.D. Mo. E.D., 1948) 79 F. Supp. 12, 19, (rev'd on other grounds, *sub nom., Pevely Dairy Co. v. United States,* 178 F.2d 363) wherein it is stated:

> "As we understand the law for the purpose of determining legal liability and responsibility a corporation has an existence separate and apart from that of the persons constituting its officers and agents and it may be guilty of violations of law apart and separate from the guilt or innocence of its officers. In this case the jury were informed in substance that in determining the guilt or innocence of the corporate defendants they should look to the acts done and declarations made by the corporate officers, agents and employees, and that a corporation is bound by and legally responsible in a criminal case for acts performed or things done by an officer, agent or employee of the corporation when such officer, agent or employee is acting within the scope of his authority and the acts of such officer, agent or employee are performed for the corporation employing him and are the duties delegated to him. See New York Cent. H. R. R. Co. v. United States, 212 U.S. 481, 29 S.Ct. 304, 53 L.Ed. 613; and Egan v. United States, 8 Cir., 137 F.2d 369, loc. cit. 379. The guilt or innocence of the corporate defendants was a jury issue of fact."

In the case at bar, the guilt or innocence of the Magnolia Motor and Logging Company was submitted to the jury as a question of fact. Thus, since the jury had an opportunity to hear the facts of the case, the Court of Appeals should be concerned only with the issue of whether or not the conviction of the corporate defendant herein is consistent with the evidence.

In *American Medical Association v. United States,* (C.A. D.C., 1942) 130 F.2d 233, 252, 253, it is stated as follows:

> "Appellants contend that the verdict of the jury acquitting all the defendants except the American Medical Association and the Medical Society of the District of Columbia, and convicting the two latter associations, constitutes such inconsistency as to require that the verdicts of guilty be set aside. *It has been held many times that inconsistency in verdicts does not require the result contended for by appellants. And this is true even though the inconsistency can be explained by no rational considerations. The question for us is whether the convictions are consistent with the evidence.* . . .
>
> "Appellants' contention confuses the concepts of corporate and individual criminal liability. When a corporation is guilty of crime, it is because of a corporate act, a corporate intent; in short, corporate commission of crime. The fact that a corporation can act only by human agents is immaterial. *How separate is the identity of the corporate person and the individual person, where criminal liability is concerned, is shown by the fact that a corporation may be found*

guilty of a crime, the essential element of which is a specific criminal intent. . . ." (Italics added)

Further, as stated in *United States v. General Motors Corporation, et al.,* (7th Cir., 1941) 121 F.2d 376, 411:

"The question on review should not be whether the verdict against the corporation is consistent with the acquittal of the individuals. *Rather it should be whether the conviction is consistent with the evidence.* In other words, we believe that the acquittal of the officers and agents, even if they had been the only persons through whom the corporations could have acted, should not operate without more to set aside the verdict against the corporations. Nor do we attach significance to the argument that the problem of inconsistent verdict in the instant case presents a different problem than when the verdicts upon two counts are inconsistent. See Dunn v. United States, 284 U.S. 390, 393, 52 S.Ct. 189, 76 L.Ed. 356, 80 A.L.R. 161; United States v. Meltzer, 7 Cir., 100 F.2d 739, 741. In fact we believe that the same rule is applicable, that consistency in a verdict is not required, and that the language in the Austin-Bagley case supra tends in that very direction.

"In any event it is conceded that although a corporation acts only through its agents, their indictment is not a condition precedent to prosecution against the corporation. The appellants insist, however, that in this case the individual defendants did in fact exhaust the list of agents and officers who could have been responsible for the acts and policies of the corporation, and that

hence 'their acquittal must mean that no agent acted unlawfully in behalf of the appellants.' On this phase of the matter, the following observations are relevant. The loss of the individual defendants was not fatal to the indictment as it charges that there were other persons to the grand jurors unknown who participated in the conspiracy. And at the trial it developed that the unnamed co-conspirators included a large number of officers and agents in addition to those named, who were also responsible for the acts and policies of the corporations convicted. It is apparent, therefore, that the acquittal did not exhaust the list of agents who could have been and were responsible for the acts and policies of the appellants.

"In substance the appellants seek to make a case for setting aside the verdict on what appears to be either jury mistake or jury leniency operating to their advantage. We hold that the Court's action in denying the motion for a new trial was proper and lay safely within the boundaries of sound judicial discretion." (Italics added)

The appellant has cited at page 11 of its Opening Brief the case of *Pevely Dairy Co. v. United States,* (8th Cir., 1949) 178 F.2d 363, for the proposition:

"The verdict of guilty as to the corporation is stripped of all semblance of logic and reason and does away with the presumption of correctness usually attributed to the verdict of a jury."

The *Pevely* case concerned an indictment and conviction of two corporate defendants for violation of the Sherman Act relative to fixing of milk prices in the

St. Louis area. Six individual defendants, officers and employees of the companies concerned, were acquitted while the two corporate defendants were convicted. The court held that the evidence, which was circumstantial, was insufficient to show a conspiracy between the defendants and in addition found that the government's evidence was as consistent with the defendants' innocence as with their guilt. The primary basis for the decision was that the evidence did not establish the guilt of *either* the individual or the corporate defendants. On the contrary, in the case at bar the record abundantly supports the verdict against the corporation which acted through a number of its employees and/or agents, not only R. Drew Lamb. It is further pointed out that the salient issue is, as stated in the *Pevely* case, supra at 370:

> ". . . whether the verdict of guilty as against the corporations is sustained by substantial evidence, and mere inconsistency in verdicts is not fatal. . . ."

Appellee agrees with the proposition as stated at page 12 of appellant's Opening Brief, that a reviewing court must be extraordinarily careful to scrutinize the record to ascertain any prejudicial error. For that proposition the appellant has cited the case of *Manley v. United States,* (6th Cir., 1956) 238 F.2d 221. In the *Manley* case the defendant was accused of several violations on different counts. He was convicted on two counts and acquitted on one. In cross-examining the defendant, the government attorney brought out that the defendant had been fired from previous em-

ployment for the reason that his accounts were short. The court held this to be reversible error on the ground that only a previous conviction can be used to impeach. But the court pointed out that the inconsistency of verdicts "alone would not justify reversal." There is nothing in the *Manley* or the *Pevely Dairy* cases which is material to the instant appeal or which would "compel this Court . . . to set aside and reverse the verdict of guilty." (Appellant's Opening Brief, page 12).

There is no doubt that R. Drew Lamb was the principal officer and agent of the corporation. Nevertheless, there is also no doubt that other employees of Magnolia Motor and Logging Company were actively engaged in the theft and depredation of the property of the United States. The statements of various witnesses stood uncontradicted that Ritchie and Wallace were hired to cut and remove timber (Tr. 587, 863, 1369); that Lynn Colby was an employee of Magnolia with the duty of sending the logs down the river from Pecwan to the Paragon Mill (Tr. 1497); that Magnolia paid the fallers, buckers, loggers and employees involved in the operations at Pecwan (Tr. 767, 1279-1280); that both Ritchie and Wallace were instructed to log throughout the unsurveyed area (Tr. 672, 870); that in the presence of Lamb a Mr. Ryerson pointed out approximately the unsurveyed area in 1951 at the Pecwan Tract (Tr. 584); that Mr. Ritchie had cut timber at the tract (Tr. 588); that a map similar to Plaintiff's Exhibit 27 was hanging on the wall of Ritchie's cabin at Pecwan and was used practically

every day in the logging operation (Tr. 590, 591, 861-862, 1318, 1320, 1398, 1505, 1515-1516); that Mr. Ritchie admitted logging in the unsurveyed strip (Tr. 648); that Mr. Ritchie and Mr. Lamb discussed the Hammond, Jenson and Wallen report while Ritchie was working for Magnolia (Tr. 651-652); that Mr. Wallace discussed the unsurveyed area with Lamb and had a copy of Plaintiff's Exhibit 27 at Pecwan and used it (Tr. 861-862); that Wallace was ordered to take the logs out of the unsurveyed area (Tr. 870). It is uncontradicted that Ritchie, Wallace and Colby were employees of the corporate defendant, Magnolia, as indicated by the above record and at pages 10 and 11 of appellant's Opening Brief. It is beyond question that under the law, an agent as lowly in the corporate structure as a salesman or logger can hold the corporate employer guilty of a criminal offense. *United States v. George F. Fish, Inc., et al.,* (2nd Cir., 1946) 154 F.2d 798. See also 19 C.J.S., Corporations, §1362. As stated in the *Fish* case, *supra,* at 801:

> "The corporate defendant makes a separate contention that the guilt of its salesman is not to be attributed to it. But the Supreme Court has long ago determined that the corporation may be held criminally liable for the acts of an agent within the scope of his employment, New York Cent. & H. R. R. Co. v. United States, 212 U.S. 481, 29 S.Ct. 304, 53 L.Ed. 613; and the state and lower federal courts have been consistent in their application of that doctrine . . ."

Therefore, it is respectfully submitted that the prosecution herein has sustained the burden of proof

under the facts and the law with relation to the conviction of the corporate defendant, Magnolia Motor and Logging Company, and that the conviction is consistent with the evidence.

II.

THE DISTRICT COURT WAS NOT IN ERROR IN DENYING DEFENDANTS' MOTION TO DISMISS THE INDICTMENT CHARGING VIOLATIONS OF TITLE 18, UNITED STATES CODE, SECTIONS 641 AND 1361.

The appellant herein has insisted throughout that the grand jury erroneously indicted appellant and its co-defendant, R. Drew Lamb, under improper provisions of the Criminal Code. They were indicted under Title 18, United States Code, Section 641 and Title 18, United States Code, Section 1361. Section 641 pertains to theft of Government property and Section 1361 pertains in essence to wilful injury or depredation against property of the United States. Under each of the statutes, where the value of the property involved exceeds $100, the proper procedure is by indictment rather than by information, since value is the basis for determining the application of either indictment or information.

The District Court has adequately disposed of the argument herein that prosecution should have been by way of information as distinct from indictment. *United States v. Lamb,* (D.C.N.D., Cal. N.D., 1957) 150 F. Supp. 310. Judge Halbert also carefully analyzed the rules concerning the construction to be

utilized where two statutory provisions apply to the same set of facts and concluded at page 312 that:

> "... it is an equally well established rule of construction that where two statutes, each proscribing some conduct not covered by the other, overlap, a single act might violate both, at least where there is some distinction between the elements of each offense, and the violator may be prosecuted under either. United States v. Beacon Brass Co., 344 U.S. 43, 73 S.Ct. 77, 97 L.Ed. 61; United States v. Gilliland, 312 U.S. 86, 61 S.Ct. 518, 85 L.Ed. 598; Toliver v. United States, 9 Cir., 224 F.2d 742; and United States v. Moran, 2 Cir., 236 F.2d 361."

The appellant has consistently sought to convert the indictment to a charge of theft of realty rather than one of theft of personalty as actually charged in the indictment. As stated by Judge Halbert in *United States v. Lamb, supra* at 313:

> "By Count I of the Indictment presently before the Court, defendants are charged with knowingly, wilfully and unlawfully stealing and converting to their own use personal property of the United States. The personal property alleged to have been stolen and converted is described in the Indictment as being approximately 10,300 fir, cedar and hemlock logs with an aggregate value in excess of $100. There is no allegation in the Indictment that these logs were growing, standing, or in fact even upon any public or Indian lands, at the time of the alleged offense. On a motion to dismiss an Indictment on the ground that it fails to state facts sufficient to constitute an offense against the United States, this Court

is bound to accept as true all well pleaded facts set forth in the Indictment. Winslow v. United States, 9 Cir., 216 F. 2d 912, 913 and cases therein cited; United States v. Chrysler Corporation, etc., 9 Cir., 180 F.2d 557; United States v. Pennell, D.C., 144 F. Supp. 320. What the government will be able to prove at a trial is one thing, but what is charged in the Indictment is quite another. It is only the latter with which the Court is now concerned on a motion to dismiss.

"It is the opinion of the Court that from the facts pleaded in the instant Indictment, all of the elements necessary to constitute a violation of §641 are presented thereby. Furthermore, the Court is of the view that there is a sufficient distinction between the conduct proscribed by §§1852 and 1853, and that proscribed by §641 to negate any intention on the part of Congress to make §§1852 and 1853 the sole sections applicable to timber, and this is particularly true when the timber has been transmuted from real property into personal property (that is, standing trees to logs or lumber).

"Section 641 applies only to the stealing or conversion of personalty belonging to the United States, whereas §1852 becomes applicable when the act of cutting, destroying or removing *timber growing on the public lands of the United States* is committed, and §1853 becomes applicable when the act of cutting, injuring or destroying *trees growing, standing or being upon any public or Indian lands* is committed. It is fundamental that standing timber (This Court can see no legal distinction between growing trees and standing timber.) is classified as realty, United States v. Sho-

shone Tribe of Indians, 304 U.S. 111, 58 S.Ct. 794, 82 L.Ed. 1213, and Capoeman v. United States, D.C., 110 F. Supp. 924; hence §641 (relating to personalty) could not be applied. In addition, §§1852 and 1853 apply to timber or trees on public land or Indian lands only, whereas §641 has no such limitation. Furthermore, in order to establish a violation of §641, the theft or conversion must be shown to have been committed with a criminal intent, or *'mens rea'*, i.e., with the knowledge that the taking is wrongful, Morissette v. United States, 342 U.S. 246, 72 S.Ct. 240, 96 L.Ed. 288; whereas, the only intent necessary to establish a 'removal' or taking of timber under §1852 is the intent to 'export or dispose of the same', cf. Teller v. United States, 8 Cir., 113 F. 273, construing an earlier and slightly different statute, and §1853 does not appear to require any *specific* intent at all. It is apparent that where §1852 overlaps §641, i.e., when it applies to severed timber (personalty) and the removal thereof, United States v. Schuler, 27 Fed. Cas. p. 978, No. 16,234, it does not require all the attributes of criminal intent, indeed, the intent need not be wrongful at all. A similar legal situation seems to exist so far as §1853 is concerned, although the possibility of such a situation is less clear since §1853 is definitely limited to cutting, injuring or destroying trees. With the aforementioned points of difference in mind, the Court is of the view that Congress did not intend to preclude the application of the general larceny statute, §641, where the taking of logs is involved, and that where the facts justify it, a prosecution under §641 is equally as proper (perhaps even more so in some instances) as one under §1852 or §1853. . . ."

Appellant relies upon the case of *United States v. Simpson,* D.C., Ore., Cr. No. 17,903, to show that an indictment under Section 641 is improper. It is submitted that this case was adequately distinguished by Judge Halbert in *United States v. Lamb, supra,* at 314, footnote 2.

Appellant, at page 15 of its Opening Brief, states:

> "From the earliest federal cases involving the cutting of standing timber on government land, the indictments have been charged under sections similar to Title 18 U.S.C.A. 1852 and 1853. See Bligh [sic] v. United States, 3 Fed. Cases 1581; U.S. v. Darton, 25 Fed. Cases 14919; Teller v. U.S., 113 Fed. 273; Shiver v. U.S., 159 U.S. 491."

In the *Bly* case, *supra,* the United States sued civilly to recover the value of logs cut from the public lands and also brought criminal charges against some of the trespassers. The Court held that the government may proceed both civilly and criminally "and judgment in one form of remedy is no bar to the prosecution of the other remedy." The criminal statute involved was Revised Statute 2461, which bears some similarity to Section 1852, Title 18, United States Code. In *United States v. Darton, supra,* the defendant was indicted for cutting timber on government land. The principal question discussed by the Court concerned intent. The action was brought under a statute which bears some similarity to Title 18, United States Code, Section 1852, but neither that case nor the *Bly* case has any bearing on the exclusiveness of that statute to the circumstances in the

case at bar. In *Teller v. United States, supra,* the defendant was charged with cutting timber from government land. The Court instructed the jury that the intentional cutting of timber on lands known to be part of the public domain constituted a violation of the law. As in the case at bar, the defendant sought to rely upon attempts to inquire at a government office if the land had been surveyed. The Court said, *supra* at pages 277-278:

> "The principles hereinbefore discussed are, we think, entirely applicable to this last contention. The land was unquestionably unsurveyed public land, and, if defendant had prosecuted his alleged honest purpose far enough, he would have ascertained that fact. But whether he knew or could have known that it was unsurveyed public land was immaterial. All he was required to know was that it was public land, surveyed or unsurveyed, and, if he knew that,—which unquestionably he did,—the fact that he endeavored to find out whether it was surveyed or not was quite immaterial; and certainly the toleration of a trespass for three weeks—or for any time, for that matter—by a special agent of the government, whose duty it was not to tolerate it at all, can be of no avail to a trespasser by way of showing that his trespassing was done with an honest purpose."

In addition at page 15 of Appellant's Brief *Shiver v. United States, supra,* is cited. In the *Shiver* case the defendant entered the land for a homestead. Before patent, he cut, removed and sold trees to his employer, and was charged and convicted of a violation of R.S. 2461. That case in no way conflicts with

the opinion of Judge Halbert in *Lamb v. United States, supra.* In addition, there is called to the attention of the Court the unreported case of *United States v. Dausey Leaton Woodruff,* (N.D.N.D., Cal. 1957) Cr. No. 11,950, wherein the defendant was convicted of a violation of Section 641 under similar circumstances.

Count One of the Indictment specified that approximately 10,300 fir, cedar and hemlock *logs* of a value of more than $100 had been stolen and converted by the defendants. The prosecution proved beyond any doubt that approximately 10,000 logs were removed and that the approximate value of the logs converted and stolen amounted to $25,800 (Tr. 426, 536, 540).

Further, it is to be noted that although appellant nominally appeals from its conviction under 18 U.S.C.A. §1361, no argument was made in its Opening Brief on this issue. It is therefore clear that there is no basis for claiming its conviction thereunder was improper. The record amply supports the conviction under this section.

It is respectfully submitted that there is no basis for reversing the conviction of appellant on the ground that prosecution should have been had under the provisions of Title 18, United States Code, Sections 1852 and 1853, rather than under the felony provisions of Sections 641 and 1361.

III.

THE CONVICTION OF APPELLANT UNDER THE INDICTMENT CHARGING VIOLATIONS OF TITLE 18, UNITED STATES CODE, SECTIONS 641 AND 1361, IS NOT A VIOLATION OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

The appellant has argued at pages 16-17 of its Opening Brief that:

> "It is a violation of due process as protected by the 5th amendment to the Constitution of the United States to charge and convict under a specific set of facts, the violation of which is either a misdemeanor or a felony, and the choice of the statute used to bring in an indictment is left to the whim of the prosecuting authorities. There cannot be different degrees of penalty for different persons for the same criminal act—this is a violation of the equal protection clause of the Constitution. (Green v. United States, 236 Fed. 2d 708, 712.)"

The *Green* case concerned a defendant who was convicted of a crime of second degree murder under an Indictment charging first degree murder. On the appeal the conviction was reversed and upon remand, he was found guilty of first degree murder. The Court of Appeals held that this did not constitute double jeopardy. On appeal to the Supreme Court the decision was reversed (355 U.S. 184, 78 S.Ct. 221, 2 L.Ed. 2d 199 (1957)). However, there is no issue of double jeopardy in the case at bar, and, therefore, the *Green* case is clearly irrelevant.

Appellant then quotes extensively at page 17 of its Opening Brief from the case of *Berra v. United*

States, 351 U.S. 131, 76 S.Ct. 685, 100 L.Ed. 1013, (1956). The Court's attention is called to the fact that the quotation consists of a portion of the dissent. The majority opinion held that the trial court properly instructed the jury that it could convict for a lesser included crime. As stated by the majority, 351 U.S. *supra* at 135:

> "Whatever other questions might have been raised as to the validity of petitioner's conviction and sentence, because of the assumed overlapping of §§145(b) and 3616(a), were questions of law for the court. No such questions are presented here."

It is further pointed out that even the position of Justice Black in the *Berra* case does not apply to the instant case, where the acts charged are not the same under Sections 641 as under 1852. That there is no issue of constitutional due process in this case is clear from the opinion of Judge Halbert in *United States v. Lamb, supra,* wherein the application of the relevant statutes are discussed.

IV.

THE VERDICT AND JUDGMENT ARE SUPPORTED BY THE EVIDENCE.

It is beyond question that a corporation can be guilty of the crimes with which appellant was charged. The argument of appellant is that because R. Drew Lamb, co-defendant, was acquitted, the corporate defendant could not be shown to have had the

necessary specific criminal intent or *mens rea.* The cases do not support this line of argument. *United States v. St. Louis Dairy Co., et al., supra; United States v. General Motors Corporation, et al., supra; American Medical Association v. United States, supra.*

The cases cited in appellant's brief on criminal intent do not support its position. In *Morissette v. United States,* 342 U.S. 246, 72 S.Ct. 240, 96 L.Ed. 288, (1952), the Supreme Court did hold that intent was an essential element under Section 641, Title 18, United States Code. The facts were that the defendant on a hunting trip picked up a few tons of used bomb casings which he later sold for $84.00 after flattening them and taking them to market. He said he had not intended to steal government property but readily admitted that he had taken the casings. The Supreme Court held that the question of intent was one which the trial court could not withdraw from the jury. This case gives no comfort to appellant since here the question of intent was decided by the jury.

In *Screws v. United States,* 325 U.S. 91, 65 S.Ct. 1031, 89 L.Ed. 1495 (1945), defendants were indicted under 18 U.S.C. Section 88. The court held that under this section it was necessary to show a specific intent to deprive a person of a constitutional right—in that case the right not to be deprived of life without due process. Since the question of intent had not been submitted to the jury, the court reversed the conviction. Again the case is irrelevant since the question of criminal intent in the instant case was submitted to the jury.

Appellant next cites *Teller v. United States, supra.* In that case the defendant was charged with cutting timber from government land. The trial court instructed the jury that the intentional cutting of timber on lands known to be a part of the public domain constituted a violation of the law. On appeal the court affirmed and stated, in answer to defendant's attempt to show his "honest purpose" in cutting the timber:

> "In June, 1898, the defendant entered 160 acres, and four other persons each entered 160 acres of the same character of lands lying in the near vicinity to those upon Cottonwood creek now in question, for which defendant paid to the United States the price required by the stone and timber act, namely, $2.50 per acre, or a total of $2,400. Defendant's counsel contend that such purchase by him of similar lands and payment therefor at about the same time as is laid in the information is a circumstance which ought to have gone to the jury as evidence that he would not intentionally commit a trespass for the sake of obtaining timber of the same character a short distance away. We entirely fail to appreciate the force of this contention." (pp. 275-6)

The defendant in *Teller* also attempted to negate criminal intent by a showing that under local custom, it was common to cut timber from land before patent was obtained. The Court disposed of that argument as follows at page 276:

> "We entirely agree with the trial court that this evidence was incompetent. A general custom to violate the law cannot, on any principles of

morality or law, justify itself. Neither can it justify an individual instance of violation of the law . . ."

Appellant argues that "Before a man can be punished his case must be plainly and unmistakably within the statute" and cites the case of *United States v. Lacher,* 134 U.S. 624, 628, 10 S.Ct. 625, 33 L.Ed. 1080 (1889) in support thereof. However, in that case the court, after stating the principle, went on to say:

"But though penal laws are to be construed strictly, yet the intention of the Legislature must govern in the construction of penal as well as other statutes, and they are not to be construed so strictly as to defeat the obvious intention of the Legislature." (Id. at p. 628)

The defendant in that case had contended that the offense with which he was charged was also covered by another section of the Criminal Code. To this the Court replied:

"The contention is that the embezzlement of a letter is punishable only under section 3891, whether it does or does not contain a thing of value; that if it does the offender is not liable under section 5467, unless he steals it; and that this is a reasonable and just construction, as the letter may have been taken without intention to abstract the article, and indeed without suspicion of the contents until the interior is explored. And it is urged that as section 146 of the Act of June 8, 1872, expressly provided a penalty for the embezzlement of a letter, 'which shall not contain' anything of value, and its substitute, section 3891, uses the language 'although it does not contain'

> anything of value, the latter section has been thereby broadened so as to punish the offense whether the letter contains an article of value or not. This view would require us to hold that the intention was to do away with the long-observed distinction between embezzling letters containing valuable matter and those which do not, and to absolve the culprit from liability for all the consequences of his unlawful act, notwithstanding the offenses of secreting, embezzling, or destroying letters of the first class are carefully defined. If section 3891 covers the embezzlement of all letters and mail matter, no reason for the larger part of section 5467 can be perceived. The construction contended for is inadmissible." (Id. at p. 632)

Appellant cites *Pevely Dairy Co. v. United States, supra,* for the proposition that a corporation cannot have an independent intent and that it is a mere creature of its individual officers. Said case has previously been discussed in Section I above.

That the corporation herein had an intent imputed to it from its agents or employees is indicated without contradiction in the record. There is no doubt that Ritchie and Wallace were hired to cut and remove timber from the Pecwan area which included the unsurveyed strip (Tr. 587, 863, 1369); that Lynn Colby was an employee of the appellant and acted for the interests of the appellant (Tr. 1497); that the workers in the woods were paid by Magnolia (Tr. 767, 1279-1280); that Lamb instructed Ritchie and Wallace to log throughout the unsurveyed area (Tr. 672, 870); that Mr. Ryerson pointed out the unsurveyed strip to

Ritchie and Lamb at the area in 1951, before the actual major logging began (Tr. 584); that the agents and employees of the appellant had and used a duplicate map of Plaintiff's Exhibit 27 which showed without doubt the unsurveyed area (Tr. 590, 591, 861-862, 1318, 1320, 1398, 1505, 1515-1516); that the agents of the appellant discussed the unsurveyed strip (Tr. 584, 861, 862, 1515-1516); that Ritchie directed the cutting in the unsurveyed area (Tr. 1345); that Belcher Abstract and Title Company of Eureka, Humboldt County, would not insure title of the unsurveyed land (Tr. 962, 1386); that the deed from Arrow Mills did not include the unsurveyed area (Tr. 1235); that Mr. Jameson of Arrow Mills knew of the unsurveyed strip from the Belcher Abstract and Title Company (Tr. 1115); that Arrow Mills did not warrant any title to the unsurveyed area (Tr. 988); that Mr. Lamb, Mr. Briggs, Mr. Ainsworth, Mr. Ritchie, and Mr. Wallace, all knew that unsurveyed land belongs to the United States (Plaintiff's Exhibit 29, Defendant's Exhibit U); that while the cutting of the timber and the taking of the logs was taking place in 1954, Mr. Lewis of the Cadastral Engineers of the Bureau of Land Management warned Mr. Wallace that the timber being cut was on government land (Tr. 385); and that Mr. Lamb told Mr. Wallace to keep cutting (Tr. 876). At least six of the plaintiff's exhibits, which were either known or could easily have been known by the co-defendant R. Drew Lamb or his attorneys, indicated without any doubt the existence of the unsurveyed area. See Plaintiff's Exhibits 8, 9, 18, 20, 22 and 27. With relevance herein the appellant fur-

ther substantiates its activities by stating that "During 1952, 1953 and 1954, logging operations in the general area were conducted by Magnolia Motor & Logging Co." (Appellant's Opening Brief, p. 4).

That the contention of the appellant herein is basically without merit is shown in the case of *United States v. George F. Fish, Inc., supra* at 801, wherein it is stated:

> "The corporate defendant makes a separate contention that the guilt of its salesman is not to be attributed to it. But the Supreme Court has long ago determined that the corporation may be held criminally liable for the acts of an agent within the scope of his employment, New York Cent. & H. R. R. Co. v. United States, 212 U.S. 481, 29 S.Ct. 304, 53 L.Ed. 613; and the state and lower federal courts have been consistent in their application of that doctrine. Zito v. United States, 7 Cir., 64 F.2d 772; C. I. T. Corp. v. United States, 9 Cir., 150 F.2d 85; Mininsohn v. United States, 3 Cir., 101 F.2d 477; Egan v. United States, 8 Cir., 137 F.2d 369, certiorari denied 320 U.S. 788, 64 S.Ct. 195, 88 L.Ed. 474; United States v. Arrow Packing Corp., 2 Cir., 153 F.2d 669. See also Director of Public Prosecutions v. Kent and Sussex Contractors, Ltd., [1944] 1 K.B. 146; Moore v. I. Bresler, Ltd., [1944] 2 All. E. R. 515, discussed in 19 Aust. L. J. 51; Chuter v. Freeth & Pocock, Ltd., [1911] 2 K.B. 832; the articles, Corporations and the Criminal Law, 11 Sol. 101; Criminal Liability of Corporations, 88 Sol. J. 97, 139; and the full discussion of corporate responsibility under the penalty provisions of the Act, Regan v. Kroger Grocery & Baking Co., 386 Ill. 284, 54 N. E. 2d 210, 219.

"No distinctions are made in these cases between officers and agents, or between persons holding positions involving varying degrees of responsibility. And this seems the only practical conclusion in any case, but particularly here, where the sales proscribed by the Act will almost invariably be performed by subordinate salesmen, rather than by corporate chiefs, and where the corporate hierarchy does not contemplate separate layers of official dignity, each with separate degrees of responsibility. The purpose of the Act is a deterrent one; and to deny the possibility of corporate responsibility for the acts of minor employees is to immunize the offender who really benefits, and open wide the door for evasion. Here Simon acted knowingly and deliberately and hence 'wilfully' within the meaning of the Act, Zimberg v. United States, 1 Cir., 142 F.2d 132, 137, 138, certiorari denied 323 U.S. 712, 65 S.Ct. 38, and his wilful act is also that of the corporation. United States v. Union Supply Co., 215 U.S. 50, 55, 30 S. Ct. 15, 54 L.Ed. 87; United States v. Illinois Cent. R. Co., 303 U.S. 239, 58 S.Ct. 533, 82 L.Ed. 773.

"Judgment affirmed."

The question of the corporation's criminal liability herein was based upon sufficient evidence to go to the jury. An appellate court will not weigh the facts and determine the guilt or innocence of an accused by a mere preponderance of the evidence, but will limit its decision to questions of law. *Burton v. United States,* 202 U.S. 344, 26 S.Ct. 688, 50 L.Ed. 1057 (1906); *Miles v. United States,* 103 U.S. 304, 26 L.Ed. 481 (1881); *Kramer v. United States,* (9th Cir., 1948)

166 F.2d 515. In addition, where there is a conflict in the evidence in the trial court, the reviewing court will accept that version which tends to support the verdict. *Evans v. United States,* (9th Cir., 1958) 257 F.2d 121.

Appellant contends (at pages 25-26 of its Opening Brief) that its logging in the hiatus area was "open and notorious, with no effort to conceal the activities being carried on." The evidence in the record does not support this argument. When Magnolia was operating on its own property in the Pecwan Tract, there was no effort to conceal its activities. However, when it began cutting in the unsurveyed area the situation changed radically. No trespassing signs were erected (Tr. 770-771). Licensed surveyors, who are uniformly accorded the courtesy of right of way through property, were refused admittance (Tr. 822). Even the government surveyors were treated as trespassers by the agents of the company. R. Drew Lamb ordered Wallace to run the United States surveyors off the unsurveyed area (Tr. 874, 875). Further, the gravity of the situation is indicated by the fact that when Wallace did not receive any document protecting him in cutting on the unsurveyed strip, he ceased to cut and terminated his business relationship with the appellant (Tr. 881).

Relative to appellant's attempt to mitigate its culpability for its acts by reliance upon alleged investigations and advice of counsel, it is submitted, first, that the cases cited by appellant from page 21 to page 26 of its Opening Brief do not support this conten-

tion, and second, that such advice or reliance is not a defense to a criminal charge. As stated above at pages 10, 25 of Appellee's Brief, there was substantial evidence of the existence of the unsurveyed strip of government land of which the appellant's counsel and its other agents were fully aware. The issue of criminal intent, including all the arguments of the appellant here made, was submitted to the jury and the jury returned a verdict of guilty.

V.

THE DISTRICT COURT'S INSTRUCTION THAT THE LAND NOW KNOWN AS TOWNSHIP 11½ NORTH, RANGE 3 EAST, HUMBOLDT BASE AND MERIDIAN, IS AND WAS THE PROPERTY OF THE UNITED STATES DURING THE PERIODS OF TIME CHARGED IN THE INDICTMENT WAS PROPER.

The court gave plaintiff's instruction number 15, which is set out as follows, to-wit:

> "You are instructed that the land now known as Township Eleven and one-half North, Range Three East, Humboldt Base and Meridian, is and was the property of the United States during the periods of time charged in the indictment."

The appellant makes the contention that the giving of this instruction was prejudicial error and that the Court invaded the province of the jury by taking from the jury what the appellant calls a question of fact. The appellant submits that the giving of this instruction caused an *ex post facto* application under the statutes.

In order to have an *ex post facto* situation certain conditions must be present. The essence of the *ex post facto* clause in Article One, Section 9, Clause 3 of the Constitution of the United States is that every law which makes criminal an act which was innocent when done, or which inflicts a greater punishment than the law annexed to the crime when committed is an *ex post facto* law. The criteria are, as stated by Justice Chase in *Calder v. Bull,* 3 Dall. 386, 390, 1 L. Ed. 648 (1798):

> "1st. Every law that makes an action done before the passing of the law; and which was innocent when done, criminal; and punishes such action. 2d. Every law that aggravates a crime, or makes it greater than it was, when committed. 3d. Every law that changes the punishment, and inflicts a greater punishment, than the law annexed to the crime, when committed. 4th. Every law that alters the legal rules of evidence, and receives less, or different, testimony, than the law required at the time of the commission of the offense, in order to convict the offender."

It is submitted, therefore, that under the above-mentioned criteria the facts in the case at bar clearly do not fall within the prohibition of the Constitution.

At page 27 of its Opening Brief the appellant states: "A survey of public land does not ascertain the boundaries of the land. *It creates them.*" The appellee does not take issue with the appellant's statement of the law. But the appellant overlooks the fact that "unsurveyed land" is part of the public lands belonging to the United States and regardless of when

boundaries are determined the land itself was always there. *Teller v. United States, supra.*

Further, it is a matter of common judicial practice for the trial court to take judicial notice of public laws. By the Treaty of Guadalupe Hidalgo, 9 Stat. 922, the Republic of Mexico ceded to the United States of America all lands within the territorial limits of California. As stated in *Standard Oil Company of California v. Johnson,* (1938) 76 P.2d 1184, 1186, 10 C.2d 758:

> "On February 2, 1848, 9 Stat. 922, by the Treaty of Guadalupe Hidalgo, the Republic of Mexico ceded to the United States government all the lands within the territorial limits of California. The United States thereby became vested with the title to all such lands not held in private ownership. Thompson v. Doaksum, 68 Cal. 593, 596, 10 P. 199 . . ."

See also *F. A. Hihn Co. v. City of Santa Cruz* (1915) 150 Pac. 62, 170 Cal. 436, 443. On the cession of California to the United States, all the public lands therein became the property of the United States. *Friedman v. Goodwin,* (C.C. 1856) Fed. Cas. No. 5,119, 1 McAll. 142. It is submitted, therefore, that the District Court could take judicial notice that the unsurveyed area in the case at bar belonged to the United States and could give such an instruction to the jury as a matter of law.

Appellant, at pages 29 to 34 of its Opening Brief, is concerned with surveys of the boundaries of the respective townships. There is nothing therein that

necessitates discussion which has not been previously distinguished above. With particular reference to the argument that Defendant's Exhibit H for Identification was improperly excluded as evidence, it is sufficient to note that said document was refused admission on the proper ground that it was hearsay and irrelevant.

It is further submitted that the appellant corporation waived its right under Rule 30 of the Federal Rules of Criminal Procedure to object to the instruction by the District Court that the "unsurveyed area" was property of the United States. Rule 30 of the Federal Rules of Criminal Procedure, with application to the instant case, states in part:

> ". . . No party may assign as error any portion of the charge or omission therefrom unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury."

As a general rule, in the absence of a request to charge or an objection to the charge given, the appellate court will not consider specifications of error based upon the trial court's instruction to the jury. *Nordgren v. United States,* (9th Cir., 1950) 181 F.2d 718, 722; *Nemec v. United States,* (9th Cir., 1949) 178 F.2d 656, 661, cert. den., 339 U.S. 985, 70 S.Ct. 1006, 94 L.Ed. 1388; *O'Connor v. United States,* (9th Cir., 1949) 175 F.2d 477; *Ziegler v. United States,* (9th

Cir., 1949) 174 F.2d 439, cert. den. 338 U.S. 822, 70 S.Ct. 68, 94 L.Ed. 499; *Shockley v. United States,* (9th Cir., 1949) 166 F.2d 704, cert. den. 334 U.S. 850, 68 S.Ct. 1502, 92 L.Ed. 1773; *Fredrick v. United States,* (9th Cir., 1947) 163 F.2d 536, 549, cert. den. 332 U.S. 775, 68 S.Ct. 87, 92 L.Ed. 360.

An objection to a requested instruction of another party before the charge is given is not sufficient as an objection to the charge. *Ziegler v. United States, supra* at 448. In the case at bar, the District Court considered in chambers and out of the presence of the jury the instructions requested by the respective parties (Tr. 116-151). The Court after giving the instructions to the jury asked the respective counsel whether there were any objection to the instructions as given. No objection as to this instant instruction pertaining to Township 11½ was then made by appellant's counsel. Therefore, it is submitted that as to this particular instruction objection thereto has been waived pursuant to the mandate of Rule 30.

CONCLUSION.

Wherefore, it is respectfully submitted that the verdict of the jury below is amply supported by evidence and that the judgment herein should be affirmed.

Dated, Sacramento, California,
November 17, 1958.

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No. 15,805

United States Court of Appeals

For the Ninth Circuit

MAGNOLIA MOTOR & LOGGING CO.,
a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

CLOSING BRIEF OF APPELLANT MAGNOLIA MOTOR & LOGGING CO., A CORPORATION.

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No. 15,805

United States Court of Appeals

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MAGNOLIA MOTOR & LOGGING CO., a Corporation,	*Appellant,*
vs.	
UNITED STATES OF AMERICA,	*Appellee.*

CLOSING BRIEF OF APPELLANT MAGNOLIA MOTOR & LOGGING CO., A CORPORATION.

ARGUMENT.

I.

THE INCONSISTENT VERDICTS, TOGETHER WITH THE NUMEROUS OTHER PREJUDICIAL ERRORS, COMPEL THIS COURT TO REVERSE APPELLANT'S CONVICTION.

It has never been, nor is it now, the contention of appellant that the inconsistency between the conviction of the appellant corporation and the acquittal of the co-defendant R. Drew Lamb, standing alone, would require the verdict of conviction to be set aside. Nor does the appellant contend that the reviewing Court has before it other than a question of whether or not the conviction is consistent with the evidence.

A verdict of a jury is normally clothed with a presumption that it is correct and based on competent and substantial evidence. It is appellant's contention, however, based on the cases cited in its opening brief, that this presumption of correctness usually attributed to the verdict of a jury does not exist in the present case.

Where a jury has acquitted the sole acting officer and agent of the corporation and yet has convicted the corporation, the verdict of guilty is so inconsistent as to be illogical and irrational. Under the language of the case of *Manley v. United States,* 238 F. 2d 221, the reviewing Court must be extraordinarily careful to scrutinize the record to ascertain any prejudicial error. The record herein contains such *other prejudicial errors* as to compel this Court to reverse the verdict of guilty.

It is appellant's earnest contention that the trial Court committed errors which were prejudicial to this defendant in charging and trying the defendants for violations of Sections 18 U.S.C.A. 641 and 18 U.S.C.A. 1361 rather than Sections 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853; in admitting into evidence plaintiff's Exhibit "III" and plaintiff's Exhibit "VI"; in refusing to admit into evidence defendant's Exhibit "H"; for instructing the jury that as a matter of law the land on which the timber was located belonged to the United States at the time the alleged crime was committed; and in failing to direct the jury to return a verdict of not guilty on the ground there was a complete lack of relevant evidence from

which a jury could properly find or infer beyond a reasonable doubt a criminal intent to steal or depredate property of the United States.

When viewed in the light of all of these prejudicial errors and the fact that the verdict of the jury is stripped of any semblance of logic or reason, appellant respectfully contends that this reviewing Court must set aside and reverse the verdict of guilty. *Peveley Dairy Company v. United States,* 178 F. 2d 363, 370-371.

II.

THE ONLY INTENT OF APPELLANT IS THAT OF THE DEFENDANT R. DREW LAMB WHO WAS ACQUITTED BY THE JURY.

The Government in its brief at page 10 states, "There is no doubt that R. Drew Lamb was the principal officer and agent of the corporation." The Government then argues that, nevertheless, other employees of the corporation were actively engaged in any alleged theft and depredation and therefore the Government has sustained its burden of proof with relation to the conviction of the corporation. The case of *United States v. George F. Fish, Inc.,* 154 F. 2d 798, is cited to support this position. First, the *Fish* case is not in point in that both the salesmen and the corporation were found guilty. Secondly, as shown in cases relied upon by the Court in the *Fish* case, a corporation can be held punishable because of the knowledge and intent of its agents where such

agents have been entrusted with authority to act. *New York Central and H.R.R. Company v. United States,* 212 U.S. 481, 29 S.Ct. 304, 53 L.Ed. 613; *C.I.T. Corp. v. United States,* 150 F. 2d 85.

In the *C.I.T. Corp.* case, the Court at page 89 states, "It is the function delegated to the corporation officer or agent which determines his power to engage the corporation in a criminal transaction."

Appellant contends that R. Drew Lamb was the only officer or agent who was clothed with the authority to perform the acts which the Government has claimed were illegal. The activity set forth in appellee's brief on pages 10 and 11 and again on pages 24 to 26 were ministerial acts carried out under the direction and orders of defendant Lamb. The Government's entire case as presented through its witnesses, was an effort to prove that Lamb had the necessary *mens re* and acted thereunder to steal and depredate property of the United States. It is inconceivable that the Government can now claim that Ritchie, Wallace, Colby, Ryerson, Briggs, Ainsworth, and Jameson knowingly, willfully, and deliberately performed criminal acts on behalf of the corporation contrary to the knowledge and authority of R. Drew Lamb and that their activity showed a distinct criminal intent of the corporation. The intent to be imputed to the defendant corporation must be that of the officers and agents who are authorized to make the decisions and act for the corporation, not employees or agents who are acting under the direction and authority of such officers and agents.

III.

THE ONLY SECTIONS WHICH COVER THE ACTIVITY CHARGED AGAINST APPELLANT ARE THE SPECIFIC SECTIONS 18 U.S.C.A. 1852 OR 18 U.S.C.A. 1853.

Appellant renews its contention that the proper statutory provision under which the defendants should have been charged, if any, was either 18 U.S.C.A. 1852 or 18 U.S.C.A. 1853. This is not based on a belief that appellant was charged with a theft or depredation of realty. The above sections clearly state that it is a crime to cut or destroy any timber growing on the public lands of the United States, to remove any timber from the public lands with intent to dispose of the same, or to unlawfully cut or injure or destroy any tree growing, standing, or being upon land of the United States. These are the specific acts under which the defendants were indicted, tried, and appellant was convicted. These were the specific crimes which Congress intended to be punished by a fine of not more than $1,000 or imprisoned not more than one year, or both. Again, quoting the language of the Honorable James Alger Fee, Judge of the United States District Court, in the case of the *United States v. Frank J. Simpson,* U. S. District Court, District of Oregon, No. C-17903, "And where there is a specific statute which talks about cutting trees, willfully injuring trees, then I think you have to go under that statute."

When the freedom and property of a person or corporation is put in jeopardy for the commission of a crime, there is an overriding presumption of innocence. The intent of Congress to declare an activity

criminal must be clearly spelled out. In the present case we have an attempt by the Government to base a conviction on *its* determination that Congress intended it to be a far more serious crime to take logs once cut than to cut or destroy or remove timber which is growing upon public lands. Judge Halbert in *United States v. Lamb,* 150 F. Sup. 310, drew this distinction when he said: "This is particularly true when the timber has been transmuted from real property into personal property (that is, standing trees to logs or lumber)."

Appellant contends this was not the intention of Congress, and where two statutory provisions apply to the same set of facts, one applying only to the specific fact situation, and the other applying generally to all similar fact situations, the specific provisions will control the general, and in a criminal prosecution the specific provision alone will be applicable.

IV.

IT WAS A VIOLATION OF DUE PROCESS AND EQUAL PROTECTION UNDER THE FEDERAL CONSTITUTION TO CHARGE ANY APPELLANT UNDER SECTIONS 18 U.S.C.A. 641 AND 18 U.S.C.A. 1361.

The United States Supreme Court in its recent decision in the case of *Bolling v. Sharpe,* 347 U.S. 497, reiterates the doctrine that the due process clause of the Fifth Amendment to the United States Constitution shall be determined an equal protection clause with respect to the actions of the Federal Gov-

ernment. Appellant wishes to reemphasize the language of Mr. Justice Black in his dissent in the case of *Barra v. United States,* 351 U.S. 131, as quoted in appellant's opening brief on pages 17 to 19, which language, although contained in a dissent, correctly states the law of this land. The rule of law was not overruled by the majority opinion as it was therein stated that the question of due process was not an issue of the case. This, however, does not detract from the accuracy of Mr. Justice Black's statement of law therein set forth.

There cannot be different degrees of penalty for different persons for the same criminal act. Appellee has not cited one case where either 18 U.S.C.A. 641 or 18 U.S.C.A. 1361 was used to convict for the activity allegedly done by appellant herein. It is the considered opinion of appellant that this is the first instance where these sections have been used to obtain a conviction for the cutting and removing of timber from Government land. On the other hand, appellant has cited in its opening brief a number of cases where there have been indictments and convictions under Sections 18 U.S.C.A. 1852 and 18 U.S.C.A. 1853, and similar earlier sections, the specific misdemeanor sections intended by Congress to cover the set of facts charged against appellant.

V.

THERE WAS NO SUBSTANTIAL OR COMPETENT EVIDENCE OF CRIMINAL INTENT, A NECESSARY ELEMENT OF THE CRIMES CHARGED.

In appellee's brief, after setting forth a discussion of the evidence which the Government feels supports the decision of the jury, it is contended that in any event, an Appellate Court will not weigh the facts and determine the guilt or innocence of the accused by a mere preponderance of the evidence, but will limit its decisions to questions of law, and as the issue of criminal intent was submitted to the jury, this reviewing Court must accept the finding of the jury. Appellant respectfully contends that this Court has the power and the duty to examine the record carefully to determine whether or not the evidence is sufficient to sustain the verdict.

As stated by the Court in *Mortenson v. United States,* 322 U.S. 369, 374, 64 S.Ct. 1037, 88 L.Ed. 1331, a reviewing Court has "never hesitated to examine a record to determine whether there was any competent and substantial evidence fairly tending to support the verdict. *Abrams v. United States,* 250 U.S. 616, 619, 40 S.Ct. 17, 18, 63 L.Ed. 1173." See also *U.S. v. Socony-Vacuum Oil Co.,* 310 U.S. 150, 254, 60 S.Ct. 811, 84 L.Ed. 1129.

In a criminal prosecution there is a legal presumption that the appellant was innocent until proved guilty beyond a reasonable doubt. Unless there is substantial evidence of facts which exclude every other

hypothesis but that of guilt, it is the duty of the trial judge to instruct the jury to return a verdict for the accused, and where all the substantial evidence is as consistent with innocence as with guilt, it is the duty of the Appellate Court to reverse a judgment against him. *Hammond v. U.S.*, 127 F. 2d 752, 753; *Isbell v. United States,* 227 F. 788, 792; *U.S. v. Silverman,* 248 F. 2d 671, 686; *Stoppelli v. United States,* 183 F. 2d 391.

Without repeating the arguments set forth in appellant's opening brief and the discussion regarding the lack of proof of intent of the corporation as set forth in Section II above, appellant firmly contends that there has been a complete lack of competent, relevant, and substantial evidence from which a jury could have found a *mens re* on the part of the appellant corporation. Further, appellant contends that the trial Court should have concluded as a matter of law that this essential element was not proved beyond a reasonable doubt.

Upon the verdict of acquittal of R. Drew Lamb, the trial Court should have directed a verdict of acquittal as to this appellant. There was no evidence of criminal intent on the part of the corporation other than that which would have proved criminal intent on the part of R. Drew Lamb. Were it not for the prejudicial errors as set forth in appellant's opening brief, and in particular the instruction to the jury determining as a legal fact that the property upon which the alleged crime was committed belonged to the United States of America, as discussed below, this

jury, as reasonable men trying the facts, would not have reached the hypothesis of guilt.

VI.

IT WAS ERRONEOUS AND PREJUDICIAL FOR THE COURT TO INSTRUCT THE JURY THAT THE UNSURVEYED LAND BELONGED TO THE UNITED STATES AND THAT CRIMINAL INTENT COULD BE FOUND IF APPELLANT KNOWINGLY TOOK PROPERTY FROM ANYONE, REGARDLESS OF WHO OWNED IT.

The appellant in its opening brief, and the Government in its reply brief, proceeded on the erroneous assumption that Instruction No. 15 as set out in both appellant's and appellee's briefs was given to the jury by the trial judge. A reading of the transcript of the proceedings subsequent to the original instructions of the Court to the jury revealed that Instruction No. 15 was not given. Rather, the Court, following an announcement from the foreman of the jury that they were hopelessly deadlocked, reinstructed the jury and gave the following instructions:

> The Court. As a matter of law, this particular unsurveyed land, which did exist, belonged to the United States of America. That is a legal fact. You are not required to find legal facts, and perhaps I should have told you this before: A legal fact is a legal conclusion and the legal conclusion dictated by the facts here as to the ownership of this land is that it belonged, as part of the public domain, to the United States of America, and not only belonged to the United States of America, but belonged to it from the day when the treaty with Mexico was effected around 1850

when California became a state. That is a legal fact.

It is also true that as a matter of law the area being in the public domain could not be rented, conveyed out of Government ownership into private ownership until such a time as the land was surveyed and the survey was accepted and filed on the official record with the Bureau of Land Management of the Department of Interior or the Federal Government. When that was done, the individual sections and subdivisions of this area could then be identified for the purpose of describing townships and sections and the like, and could be incorporated into legal documents called patents or deeds, but the disposal features —the means by which the Federal Government can dispose of public land by conveying them to private individuals by way of patent—is an interesting subject, but it isn't particularly relevant to what we are here dealing with. Here basically the question for you to decide is whether or not the defendant knew or honestly believed that he or the corporation owned this particular area. He might have been mistaken and would have been mistaken if he so believed because it did in fact belong to the United States; but, if from where he stood and looked he believed honestly that it belonged to him and that he was justified in acting as he in the corporation did, then, of course, there's absent and lacking any criminal intent; and, under those circumstances, the verdict required by the law must be not guilty. On the other hand, if the defendant knew or should know from all the signs and surrounding circumstances that at least neither he nor the corporation owned this land, even though he didn't know

> who owned, if he knew and it knew it didn't own the land, but nevertheless these acts were performed with the intent to deprive whoever owned the land permanently of these logs, or, if, regardless of who owned the land there was an intent to despoil this forest area, and that the defendant did these acts knowingly, willfully, deliberately, purposely, well knowing the law prohibited the doing of these acts regardless to whom this property belonged, then under those circumstances, you have present at the time of the doing of these acts the element of criminal intent, and under those circumstances, the verdict required by law is one of guilty.

Following this instruction, Mr. Wilkins, counsel for appellant, made a lengthy exception to the instructions based on his prior arguments given at the time of settling of instructions which are before this Court.

Appellant contends that this instruction was prejudicially erroneous for the reasons set forth in appellant's opening brief commencing at page 26 and concluding on page 34. The presumption of innocence to which appellant was entitled was overcome by this instruction from the Court which told the jury that the property taken was that of the United States and directed them, in effect, to return a verdict of guilty if they found that the defendants cut and removed the property.

In the first place, the Court, in effect, told the jury that it need not be concerned with such issues as the title to the land, the alleged hiatus, the Government's belief that no hiatus existed, the efforts of Lamb to

determine his rights in the alleged hiatus, the fact that the corrected survey was not filed and the boundaries created until approximately two years after the alleged crime, the limitations of the Government in unsurveyed public domain—all elements tending to prove the lack of criminal intent, and the very heart and essence of appellant's defense.

In the second place, the Court goes beyond the scope of the code sections under which the defendants were charged by instructing the jury that they could find the necessary criminal intent if appellant knowingly took property or depredated land owned by anyone other than itself. The only crimes charged are the taking or depredating of *United States* property, and the only *mens re* to be found is the intention to take or depredate *United States* property.

It is prejudicial and in grave error to instruct the jury that it can find the necessary criminal intent to convict appellant if Lamb knew or should have known that the acts performed were "with the intent to deprive whoever owned the land permanently of these logs, or if, regardless of who owned the land, there was an intent to despoil this forest area, and that the defendant did these acts knowingly, willfully, deliberately, purposely, well knowing the law prohibited the doing of these acts, regardless to whom this property belonged." It is not a crime against the United States to cut and remove logs of someone other than the United States.

Further, in giving the instruction at a time when the jury had announced it was hopelessly deadlocked,

substantially more emphasis was given to this instruction by the jury than normally would have been given, and appellant was thus deprived of a fair and impartial trial.

CONCLUSION.

We respectfully renew our request that the judgment of conviction be reversed for the reasons set forth in appellant's briefs on file herein.

Dated, December 26, 1958.

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No. 15806

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ROYAL MAIL LINES, LTD.,

Appellant,

vs.

JOSEPH PECK and ASSOCIATED-BANNING CO.,

Appellees.

APPELLANT'S BRIEF ON REHEARING.

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INTRODUCTION.

Appellant respectfully refers to its Opening Brief and its Reply Brief and incorporates the same herein. Appellant relies upon the arguments made in said briefs and here seeks only to meet arguments advanced by Associated-Banning's Brief on Rehearing.

I.

The District Court's Judgment on the Indemnity Question Should Be Reversed and Judgment Ordered for Appellant.

A. The Undisputed Facts.

The following facts are incontrovertibly established:

1. When Associated-Banning took over PARIMA, the boom in question was secure and safe. Regardless of how many turns of the line there were around

the bitts, the overlying figure 8's were sufficient to hold the boom in place. The boom had been rigged by means of a chain stopper by the ship's crew on the morning preceding the accident. [R. 177-183, 188, 199.]

2. Before stevedore foreman Wicks started to lower the boom, it could have been lowered either by means of a chain stopper or by surging. [R. 50, 58, 59, 119-120, 176.]

3. Of these two methods, use of a chain stopper was by far the safer. [R. 97-98, 177.] Both methods required about the same amount of time and effort. [R. 58-59, 120, 177.]

4. A chain stopper was available either at the bitts or for the asking. [R. 179, 180, 184.]

5. Whichever of these methods is used to lower and rig a boom, more than one man is required for the job. [R. 48, 49, 120.]

6. It would have been possible for a sufficient number of men to surge the line. (Associated-Banning disputes this fact on page 2 of its Brief on Rehearing, stating that "There was but room for one man, Wicks, at the place down in the deck load where the figure eights were removed." This statement is not supported by the evidence; the only testimony on the question is inconclusive. [R. 57, 58.] Even if only one man could actually work at the bitts, it is not true that there was no room for two or three additional men to assist in the surging by holding the line on the slack side of the bitts. Examination of the photographs in evidence clearly demonstrates this. Ineed, two of plaintiff's witnesses who

at the time were employed by Associated-Banning testified that just before the accident they were on their way to help Wicks by holding onto the line. [Testimony of Brookshire, R. 90; testimony of Enyeart, R. 111.]) It is undisputed that two members of the ship's crew were able to raise the boom that very morning. [R. 174-177.]

7. When lowering the boom by the surging method it is necessary to remove each turn of wire carefully, including the figure 8 turns, testing to see if the weight of the boom can be supported and it is often necessary to use figure 8 turns in addition to round turns to support the boom. [R. 48, 67-69, 73-74.]

8. After making the round turns Boatswain Donovan and Seaman Rowbottom "made a number of figure 8's to the top of the bollards" [R. 199]—at least four figure 8 turns. [R. 176, 188.] Thus there was always a sufficient number of turns and figure 8's to support the boom.

B. The One Disputed Fact.

The single factual dispute was whether there were two or three or more turns on the bitts beneath the figure 8's. As shown below, even if there had only been two turns, that fact would be immaterial, because it would not establish a breach of duty on the part of Appellant or negative negligence on the part of Associated-Banning, and judgment should be in favor of Appellant.

A finding that there were only two turns would be against the weight of the evidence. Only the deposition witness, Enyeart, an employee of Associated-Banning, testified that there were two turns. He was in no position to see, his eyes being about 13 feet *above* the bitts.

Examination of the photographs of the area and of the bitts demonstrates that Enyeart actually could not have been able to tell for sure whether there were one, two, three, four, five or six turns, from where he stood.

Testimony of the boatswain Donovan, the man who actually saw and supervised the securing of the line to the bitts, and of Rowbottom, the seaman who actually wound the line around the bitts, is squarely opposed to that of Enyeart and should be given great weight.

Neither Peck nor Associated-Banning called Wicks to testify for them, yet his testimony concerning the number of turns would have been most interesting. Since he was an employee of Associated-Banning it is to be presumed that Wicks would not have testified that there were only two turns. (Cal. Code Civ. Proc., Sec. 1963(5)(6).) Wicks must have been able to see how many turns there were. Had there been but two, he surely should not have attempted to surge the line by himself.

Whether there were two or more round turns is actually immaterial and has no causal relation to the accident because Wicks should have tested each turn as he removed them and used all or part of the available figure eight turns as was necessary in addition to the existing round turns to surge the boom. The only witness who saw what Wicks did testified that he removed all the figure eights in less than thirty seconds! [Testimony of Enyeart, R. 137.]

II.

The Facts Conclusively Show That Associated-Banning Breached Its Duty Under the Stevedoring Agreement.

It is uncontroverted that Associated-Banning attempted to rig the boom in a dangerous manner (*i.e.,* by surging) when a safe method (*i.e.,* using the chain stopper) was possible. This alone constitutes a breach of duty under the rule of the *Ryan* and *Weyerhaeuser* cases.

It is also uncontroverted that Associated-Banning was attempting to surge the line in an extremely negligent fashion, *i.e.,* by using one man instead of three or four to do the job and by not carefully testing each turn as it was removed from the bitts. This was negligence of the grossest, most foolhardy sort and clearly constituted breach of duty.

Peck's injury quite clearly was the foreseeable result of these breaches of duty. Thus, absent conduct on the part of Appellant nullifying Associated-Banning's obligation to indemnify it, Appellant is entitled to indemnity.

> *Weyerhaeuser Steamship Co. v. Nacirema Operation Co., Inc.,* 355 U. S. 563, 2 L. Ed. 2d 491 (1958).

III.

Appellant Is Not Precluded From Recovering Indemnity by Its Conduct.

A. Appellant Breached No Duty Owed by It to Associated-Banning.

I.

To determine whether a shipowner has breached its duty to a stevedore, that duty must first be defined.

At the time this case was originally briefed and argued, there was very little authority defining the duty owed a contracting stevedoring company by a shipowner. In its Reply Brief, Appellant argued that the shipowner's duty is "to turn over its ship to the stevedoring company in a reasonably safe and fit condition for the service to be rendered." (Appellant's Rep. Br. p. 8.) Associated-Banning on the other hand has argued, and now bases its case upon the argument, that the shipowner's duty *vis-a-vis* stevedore is the *same* as its duty *vis-a-vis* the longshoreman.

The shipowner's duty has recently been defined by the learned and complete opinion of the Honorable William Mathes in *Hugev v. Dampskisaktieselskabet International,* ..... Fed. Supp. ....., 1959 A. M. C. ..... (S. D. Cal., No. 20340-WM; decision filed Jan. 21, 1959). This opinion has not as yet been published so we quote from it here at length:

> "Defendant shipowner admits owing an implied warranty of seaworthiness to plaintiff longshoreman, and a breach of that warranty 'due to insecure hatch boards at No. 1 hatch'; also that such breach was one of the proximate causes of plaintiff's injuries. But the shipowner asserts that this unseaworthy con-

dition did not constitute a breach of any obligation owed by the shipowner to the stevedoring contractor.

"The implied warranty of the shipowner as to seaworthiness, first raised by law in favor of the shipper of cargo [*The Caledonia,* 157 U. S. 124, 130 (1895)], later extended to seamen [*The Osceola,* 189 U. S. 158 (1903)], and still later to longshoremen [*Seas Shipping Co. v. Sieracki,* 328 U. S. 85, 89-94 (1946)], does not extend to the stevedoring contractor. Those considerations of reason and policy which prompted extension of the benefit of the warranty to the individual longshoreman, absent any contractual relationship, do not exist with respect to his employer, the contracting stevedore. [Cf. *Kermarec v. Compagnie Generale Transatlantique,* 245 F. 2d 175 (2d Cir. 1957), *cert. granted,* 355 U. S. 902 (1957); 27 U. S. L. Week 3166 (U. S. Dec. 2, 1958) (No. 22).]

"The stevedoring contractor represents himself to be, and is assumed to be, expert and experienced in the work of loading and unloading cargo, while the individual longshoreman may or may not be. Moreover, since predicated upon principles of tort liability rather than contract, the obligations imposed by law upon the shipowner in favor of an individual longshoreman coming aboard ship to work in loading or unloading the cargo are quite different from the obligations of the shipowner in favor of the longshoreman's employer arising from the stevedoring contract. It is necessary, then, to look to the stevedoring contract to learn what obligations are there imposed upon the shipowner—not by law, but by contract—in favor of the stevedore employer.

"Where, as here, the terms of the stevedoring contract do not expressly impose upon the shipowner any material obligation beyond that of payment to

cover the stevedoring service, all additional contractual obligations on the part of the shipowner must, as with the stevedores in *Ryan* and *Nacirema,* be implied in fact from the inferences necessarily arising out of the circumstances surrounding the contract and its performance. [Cf. Weinstock, The Employer's Duty to Indemnify Shipowners for Damages Recovered by Harbor Workers, 103 U. of Pa. L. Rev. 321, 342-346 (1954).]

"The stevedoring agreement is a maritime contract [*Atlantic Transport Co. v. Imbrovek,* 234 U. S. 52, 61-62 (1914)], so any obligations to be implied as in fact arising from the contract should take cognizance of the maritime considerations involved. Ships, as well as seamen and longshoremen, are subject to the 'hazards of maritime service.' Ships still break up at sea. Even though the ships of today may not be as vulnerable, the typhoons of our day are as 'formidable and swift' as when Conrad wrote. The Pacific Coast is as treacherous now as it was some two generations ago when the Nottingham was battered into a hulk off the Oregon coast. [*The Nottingham,* 236 Fed. 618 (9th Cir. 1916).]

"In almost every instance, when a stevedoring contractor commences the work of loading or unloading a seagoing vessel, the ship has arrived in port only a few hours before. She may have been at sea for weeks or months. Almost always, she has ridden some heavy seas. Often she may have rolled and pitched through mountainous seas for days, taken thousands of tons of water over her decks, sailed through freezing and tropical weather, and been beaten by 100 mile an hour gales. Almost surely she will have been serviced by stevedores of varying degrees of competency in other ports throughout the world.

"Being a mass of plates, pipes, wires, beams and various mechanisms, each to some degree vulnerable to the elements, it would be much too much to expect a cargo vessel to arrive in port with all equipment, appliances and facilities in a fully seaworthy condition. Especially is this true with respect to the hatches, booms and winches, which are relatively more likely to be in disorder because of the elements, and the abuse and misuse of men as well. It is reasonable to expect, then, that many things may be wrong with a freighter and her equipment and appliances when she arrives in port; that she may well be a place of danger even as she docks. And all of these lurking dangers may be due entirely to the hazards of the ship's service.

"The stevedoring contractor knows that the ship has been at sea; that she may be in many respects dangerous to the life and limb of an unskilled person; that if a condition is found which is unsafe for the professional longshoreman, as a rule the contractor can remedy it at the expense of the shipowner; that if the stevedoring operations are thereby delayed, the shipowner normally must pay for standby time.

"Stevedoring contractors hold themselves out as being trained and equipped to cope with these conditions and these dangers. To this end, the stevedoring contractor is usually given full use and charge of the ship's loading and unloading equipment and appliances and the cargo hatches and holds. So it is that the stevedoring contractor cannot reasonably expect, and does not expect, to board a vessel which in all respects, as to equipment and applicances as well as hull, is in a seaworthy condition, or even in a reasonably safe condition. Hence it is not reasonable to infer that the shipowner, in executing the

stevedoring contract, impliedly covenants that the condition of the ship or of her equipment or appliances will exceed the stevedoring contractor's reasonable expectations.

"This is not to suggest that the surrounding circumstances are such as to require the contract to be so construed that the stevedoring contractor boards the vessel wholly at peril. To the contrary, with the shipowner, as with the stevedore, certain obligations are to be implied in fact as being of the essence of the stevedoring contract. [*Ryan Stevedoring Co. v. Pan-Atlantic S.S. Corp., supra,* 350 U. S. at 133.]

"Although admonished in *Ryan* that resort may not be had to principles of quasi-contract or to the law of torts to ascertain the obligations of the shipowner *vis-a-vis* the stevedoring contractor, it is helpful in considering the surrounding circumstances of fact and law, in the light of which the stevedoring contract was made, to recall the long-settled rule that the shipowner owes a duty of ordinary care imposed by law toward 'persons rightfully transacting business on ships . . .' [*Pope & Talbot, Inc. v. Hawn, supra,* 346 U. S. at 413, n. 6; and see e.g., *The Max Morris,* 137 U. S. 13 (1890); *Leathers v. Blessing,* 105 U. S. 626 (1882); *Tidewater Associated Oil Co. v. Richardson,* 169 F. 2d 802 (9th Cir. 1948).]

"The surrounding circumstances of fact, and that of law just recited, prompt the holding that, absent express provision to the contrary, the shipowner owes to the stevedoring contractor under the stevedoring contract the implied-in-fact obligations: *(1) to exercise ordinary care under the circumstances to place the ship on which the stevedoring work is to be done, and the equipment and appliances aboard ship, in such condition that an expert and experienced steve-*

doring contractor, mindful of the dangers he should reasonably expect to encounter, arising from the hazards of the ship's service or otherwise, will be able by the exercise of ordinary care under the circumstances to load or discharge the cargo, as the case may be, in a workmanlike manner and with reasonable safety to persons and property; and (2) to give the stevedoring contractor reasonable warning of the existence of any latent or hidden danger which has not been remedied and is not usually encountered or reasonably to be expected by an expert and experienced stevedore in the performance of the stevedoring work aboard the ship, if the shipowner actually knows or, in the exercise of ordinary care under the circumstances, should know of the existence of such danger, and the danger is one which the shipowner should reasonably expect a stevedore to encounter in the performance of the stevedoring contract. [Cf. *Parenzan v. Iino K.K.K.,* 251 F. 2d 928 (2d Cir. 1958), *cert. denied,* 356 U. S. 939 (1958); *Amerocean S.S. Co. v. Copp,* 245 F. 2d 291 (9th Cir. 1957); *United States v. Harrison,* 245 F. 2d 911 (9th Cir. 1957); *Southport Transit Company v. Avondale Marine Ways,* 234 F. 2d 947, 951 (5th Cir. 1956); *American President Lines v. Marine Terminals Corp.,* 234 F. 2d 753 (9th Cir. 1956), *cert. denied,* 352 U. S. 926 (1956); *Berti v. Compagnie de Navigation Cyprien Fabre,* 213 F. 2d 397 (2d Cir. 1954); *Crawford v. Pope & Talbot, Inc.,* 206 F. 2d 784, 792 (3d Cir. 1953); *Slattery v. Marra Bros.,* 186 F. 2d 134, 139 (2d Cir. 1951); *United States v. Rothschild Int. Stevedoring Co.,* 183 F. 2d 181 (9th Cir. 1950); *American Mut. Liability Ins. Co. v. Matthews,* 182 F. 2d 322 (2d Cir. 1950); *United States v. Arrow Stevedoring Co.,* supra, 175 F. 2d at 331; *Calanchini v. Bliss,* 88 F. 2d 82 (9th

Cir. 1937); *Cornec v. Baltimore & Ohio R.R. Co.,* 48 F. 2d 497, 502 (4th Cir. 1931), *cert. denied,* 284 U. S. 621 (1931); *Seaboard Stevedoring Co. v. Sagadahoc S.S. Corp.,* 32 F. 2d 886 (9th Cir. 1929); *Bethlehem Shipbuilding Corp. v. Joseph Gutradt Co.,* 10 F. 2d 769, 771 (9th Cir. 1926); 2 Restatement, Torts, §§360, 332, comment h (1934); 2 Harper & James, The Law of Torts, §27.17 (1956).]

"The evidence is not such as to warrant a finding that the shipowner here breached either of these implied-in-fact obligations of the stevedoring contract in any respect. On the contrary, the evidence establishes full performance by the shipowner. [Cf. *American Mut. Liability Ins. Co. v. Matthews,* supra, 182 F. 2d at 324.]

"Of course, as third-party defendant points out, there is a third implied-in-fact obligation on the part of the shipowner not unreasonably or materially to hinder, delay or interfere with performance of the stevedoring operations. [Restatement, Contracts, §§295, 315 (1932); 4 Corbin, Contracts, §947 (1951)]. However, there is no evidence of any unreasonable or material prevention of performance on the part of the shipowner in the case at bar. The contract expressly provides that the stevedoring contractor is to be paid on a time basis for service of every kind, including the repair of defects in hatches or other ship appliances and equipment, and that the contractor is to be paid also for standby time due to any delay in the stevedoring operations caused by the shipowner.

"Accordingly, the finding must be that the shipowner at bar did not breach, but fully performed, both its express and implied-in-fact obligations to the stevedoring contractor under the contract."

Another recent case in point is *Vladmir v. Johnson Line,* 1959 A. M. C. ..... (S. D. Cal., No. 1044-57 T; decision filed Nov. 5, 1958), where the Horonable Ernest Tolin held that shipowner's duty to stevedore is only to "furnish a vessel reasonably capable of being unloaded by a careful, expert stevedore."

B. The Claimed Breach of Duty by Appellant.

On page 8 of its Brief on Rehearing, Associated-Banning argues that, since a claim for indemnification sounds in contract, Appellant was required to demonstrate that it did not breach *any* duty owed Associated-Banning. This stretches the contractual theory too far. It is well to remember that although the duties and liabilities as between shipowner and stevedore arise out of contract, tort principles of proximate cause, intervening cause, etc., must in the last analysis be looked to in placing liability.

Reddick v. McAllister Lighterage Line, Inc., 258 F. 2d 297 (2d Cir., 1958), cert. denied, 27 U. S. L. Week 3176 (U. S. Dec. 9, 1958);

Revel v. American Export Lines, 162 F. 2d 279 (E. D. Va., 1958).

Thus, Associated-Banning could not defend herein on the basis of a breach of duty by Appellant unrelated to the accident and occurring at the bow of PARIMA or at Hatch No. 5. (Peck was injured at Hatch No. 3.) Consequently, Appellant should not be required to show performance of all its duties unrelated to the accident in question.

There is no issue herein as to who, Appellant or Associated-Banning, had the burden of proof on the question whether Appellant duly performed its relevant duties. It would appear, however, that the burden should be upon the stevedore, as in the case of contributory negligence.

At the very least, the stevedore should be required to go forward on the issue to the extent of stating which duties it claims were relevant to the injury and were breached. Associated-Banning has done this, claiming that Appellant breached its duty by turning over PARIMA with two rather than three or four turns on the bitts.

C. Appellant Breached No Duty.

Its duty to Associated-Banning as shipowner having been defined and a specific breach of duty having been claimed, it is clear that Appellant is not precluded from recovering indemnification. If there had only been two turns:

1. It is inconceivable that Wicks would not have seen this. (See photographic exhibits; if Enyeart standing where he was could see it, how could Wicks have missed seeing it?)
2. A careful, expert stevedore must be presumed to have had knowledge of it. (See photographic exhibits.)
3. A careful, expert stevedore would have lowered the boom by means of a chain stopper, thus making it unnecessary to rely at all on the turns and figure eights on the bitts.
4. A careful, expert stevedore could have safely lowered the boom by surging if a sufficient number of men had been employed to do the job.
5. A careful, expert stevedore would have tested each turn as removed and would have used the available figure 8's in addition to round turns, if necessary.

The facts being such, no duty was breached by Appellant and it is entitled to indemnity. *Hugev v. Dampskisaktiesclakabet International, supra.*

D. Authorities Cited by Appellee Associated-Banning.

Associated-Banning cites two cases as indicating that shipowner's duty to stevedoring contractor is the same as its duty to longshoreman. Neither case is authority for that proposition.

(a) *Oleszcuk v. Calmar*, 164 Fed. Supp. 628 (D. Md., 1958), is not in point. There the shipowner by *express written agreement* took on duties additional to those which are implied in fact where the contract is silent as here and in the *Ryan* and *Weyerhaeuser* cases. In that respect the case is similar to *Hagans v. Farrell Lines, Inc.*, 237 F. 2d 477 (3d Cir., 1956).

(b) *Smith v. Pan-Atlantic Steamship Corp.*, 161 Fed. Supp. 422 (E. D. Pa., 1957), requires careful reading. The District Court decided the case on August 6, 1957. The *Weyerhaeuser* case was decided March 3, 1958, but was not reported in the advance sheets until several weks later. The appeal in *Smith v. Pan-Atlantic* was argued April 14, 1958, and decided April 30, 1958, the Court writing only a short *per curiam* opinion (254 F. 2d 600). Thus, the case might be considered as either a pre-*Weyerhaeuser* or a post-*Weyerhaeuser* case.

Whether the decision in *Smith v. Pan-Atlantic* be considered a pre-*Weyerhaeuser* or a post-*Weyerhaeuser* decision, it is wrong!

Considering it as a pre-*Weyerhaeuser* decision, the District Court's rhetorical question, at page 423:

> "Is it part of a stevedoring contract that the stevedore will walk off the job if it finds the ship's equipment unsuitable?"

must be answered in the affirmative rather than, as Judge Kirkpatrick supposed, in the negative.

Parenzan v. Iino Kaiun Kabushiki Kaisya, 251 F. 2d 928 (2d Cir., 1958), *cert. denied,* 356 U. S. 939, 2 L. Ed. 2d 814;

United States v. Harrison, 245 F. 2d 911 (9th Cir., 1957);

American President Lines v. Marine Terminals Corp., 234 F. 2d 753 (9th Cir., 1956), *cert. denied,* 352 U. S. 926, 1 L. Ed. 2d 167;

Berti v. Compagnie de Navigation, etc., 213 F. 2d 397 (2d Cir., 1954);

United States v. Rothschild Int. Stevedoring Co., 183 F. 2d 181 (9th Cir., 1950);

United States v. Arrow Stevedoring Co., 175 F. 2d 329 (9th Cir., 1949), *cert. denied,* 338 U. S. 904, 94 L. Ed. 557;

Hugev v. Dampskisaktieselskabet International, ... Fed. Supp. ....., 1959 A. M. C. ..... (S. D. Cal., No. 20340-WM, decision filed Jan. 21, 1959).

This is especially true in the present case where the stevedore contract provides, in paragraph 8, for compensation for "Detentions, waiting and standby time" occasioned by such action. [R. 214.]

Judge Kirkpatrick states that it might be negligence toward the longshoreman for the stevedore not to walk off the job, but that such negligence is not a breach of the stevedoring contract but is "in furtherance" thereof. This view is squarely opposed to the *Ryan* case where the Supreme Court stated:

> "Competency and safety of stowage are inescapable elements of the service undertaken." (350 U. S. 133, 100 L. Ed. 142.)

Judge Kirkpatrick further states:

> "The only ground for this third-party action is the contractual obligation assumed by the stevedore to do the work in a proper, safe and workmanlike manner." (161 Fed. Supp. 423.)

But three paragraphs later he states:

> "In the present case, the alleged default of the stevedore was not in breaching its contract but in carrying it out under conditions created by the shipowner." (161 Fed. Supp. 423.)

The Judge concedes that the stevedore knew of the defective device and yet goes on to hold that a contract to do something safely can be performed by knowingly doing the thing unsafely! We see no logic or reason, justice or equity, in this remarkable theory and know of no authority therefor.

Considering the case as a post-*Weyerhaeuser* decision, it is equally fallacious. Viewed in this light, the case merely involves a problem of causation, the question being whose breach of duty actually caused the injury. Judge Kirkpatrick finds for the stevedore because its

> "negligence . . . does not supersede Pan-Atlantic's *violation of its duty to furnish Ryan with seaworthy equipment.*" (Emphasis added.)

As authority for the unique proposition that the shipowner *had* a duty to breach and that duty was to provide *seaworthy* winches, the Court relies solely on *Hagans v. Farrell Lines,* 237 F. 2d 477 (3d Cir., 1956).

Hagans v. Farrell Lines is no authority whatsoever for such a proposition because that case involved a stevedore contract which was not silent as to duty, but *expressly required the shipowner to provide such winches.* In af-

firming *Smith,* the Third Circuit also relied solely on the decision in *Hagans v. Farrell Lines,* stating, incorrectly, that there was no essential difference between the cases. Moreover, it has recently been noted that "The indemnity feature of *Hagans* appears to have been discarded." *Revel v. American Export Lines, supra,* at p. 282.

CONCLUSION.

It is respectfully submitted that nothing has been presented by Associated-Banning in either its Petition for Rehearing or its Brief on Rehearing which alters the conclusions presented in Appellant's Opening Brief, Reply Brief and the present Brief. Judgment in favor of Associated-Banning on the third party complaint should be reversed and the cause remanded to the court below with directions to enter judgment against Associated-Banning for Appellant's damages herein, including its costs in all courts. The uncontroverted facts and recent holdings compel such a decision.

Respectfully submitted,

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No. 15814

See: Vol. 3082

IN THE

United States

Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL ASSOCIATION OF MACHINISTS, LODGE 942, AFL-CIO,
Respondent.

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On Petition for Enforcement of an Order of the National Labor Relations Board

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BRIEF FOR AMICUS CURIAE, ALLOY MANUFACTURING COMPANY

RICHARD W. AXTELL
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KERSHAW'S, INC.

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BRIEF FOR AMICUS CURIAE, ALLOY MANUFACTURING COMPANY

RICHARD W. AXTELL
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Attorneys for Amicus Curiae.

I.

STATEMENT OF PLEADING AND FACTS

The basis upon which it is contended that the Court of Appeals has jurisdiction of this matter is set forth in the brief of the Petitioner. Amicus Curiae is in accord with the statment of jurisdiction by the Petitioner.

By virtue of the leave granted by the Court on June 25, 1958, Alloy Manufacturing Company files this brief as Amicus Curiae. Amicus Curiae has a direct interest in the decision in this matter in that the unlawful picketing and appeals to its customers by the Respondent Union have had and continue to have a detrimental effect on the business and financial status of the Company.

In the interest of brevity, Amicus Curiae accepts the resume of Pleadings and Proceedings as set forth in the Petitioner's brief and accepts the statement of facts as set forth in Pages 2 to 7 of the Petitioner's brief.

II.

STATEMENT OF THE CASE

The issues in the present case are:

1. Whether picketing, with the avowed purpose of obtaining the employer's signature to a contract the terms of which require recognition of the Union as bargaining agent and require membership in the Union, in the absence of the Union being certified by the National Labor Relations Board, has a tendency

to coerce and restrain the Employees of the subject Employer within the meaning of Section 8(b)(1)(A) of the National Labor Relations Act.

2. Whether within the meaning of Section 8(b)(2) of the Act such a course of conduct causes or attempts to cause the subject Employer to discriminate against the Employees in violation of Section 8(a)(3) of the Act.

3. Whether continued picketing and economic pressure (publication of the subject Employer's firm on a Union "We Do Not Patronize" list and appeals by Union representatives to the subject Employer's customers to cease dealing with the subject Employer) before and after a duly certified National Labor Relations Board election in which the Union has been unanimously rejected by the Employees has a tendency to coerce and restrain the Employees of the subject Employer within the meaning of Section 8(b)(1)(A) of the National Labor Relations Act.

4. Whether within the meaning of Section 8(b)(2) of the Act such a course of conduct causes or attempts to cause the subject Employer to discriminate against the Employees in violation of Section 8(a)(3) of the Act.

III.

SPECIFICATION OF ERRORS

Amicus curiae does not assert that any errors were committed by the National Labor Relations Board in its determination of this matter. The position of

amicus curiae is in support of the Decision and Order as amended January 30, 1958, by the National Labor Relations Board.

IV.

ARGUMENT

A. Picketing may be prohibited if shown to be for an unlawful purpose.

B. The purpose of the picketing and economic pressure (publication of the subject Employer's firm on a Union "We Do Not Patronize" list and appeals by Union representatives to the subject Employer's customers to cease dealing with the subject Employer) herein is unlawful and coercive.

C. Reason and logic support the rule that picketing and economic pressure after repudiation in a National Labor Relations Board election and picketing and economic pressure for a union shop contract in the absence of being certified as bargaining representative is coercive and prohibited under Sections 8(b)(1)(A) and 8(b)(2) of the National Labor Relations Act.

A. Picketing May Be Prohibited If Shown to Be for An Unlawful Purpose.

The case of *Thornhill v. Alabama* (310 U. S. 490) sets forth the general rule that picketing may be free speech and protected by the First Amendment to the United States Constitution. The *Thornhill* case was decided in 1940 and since that time there have been many factual situations superimposed upon this gen-

eral rule with varying results. There have also been pronouncements by the United States Supreme Court that "picketing is not equivalent to speech." *Bakery Drivers v. Wohl* (315 U. S. 769). As will be shown the broad statement of immunity in the *Thornhill* case has been greatly modified in cases of coercive picketing.

In *Giboney v. Empire Storage and Ice Company* (336 U. S. 490) (1949) at Page 498 the United States Supreme Court was asked to decide whether the picketing union could, on the basis of free speech, violate a Missouri antitrust statute. The Court stated,

> "Neither *Thornhill v. Alabama,* supra, nor *Carlson v. California* (310 U. S. 106), both decided the same day, supports the contention that conduct otherwise unlawful is always immune from state regulation because an integral part of that conduct is carried on by display of placards by peaceful picketers. In both these cases this Court struck down statutes which banned dissemination of information by people adjacent to certain premises, pointing out that the statutes were so broad that they could not only be utilized to punish conduct plainly illegal but could also be applied to ban all truthful publications of the facts of a labor controversy. But in the *Thornhill* opinion, at pages 103-104, the Court was careful to point out that *it was within the province of states 'to set the limits of permissible contest open to industrial combatants.'* " (Emphasis supplied)

On this basis the United States Supreme Court affirmed the decision of the Missouri court in granting the injunction.

A case which arose in Washington, as did the in-

stant case, is that of *Building Service Employees International Union v. Gazzam* (339 U. S. 532, 70 Sup. Ct. 784) (1950). The question as stated by the U. S. Supreme Court in that case in the beginning of the opinion was:

> "It is the public policy of the State of Washington that employers shall not coerce their employees' choice of representatives for purposes of collective bargaining. Do the First and Fourteenth Amendments to the Federal Constitution permit the state, in reliance on this policy, to enjoin peaceful picketing carried on for the purpose of compelling an employer to sign a contract with a labor union which coerce's his employees' choice of bargaining representatives?"

The U. S. Supreme Court reasoned (P. 537):

> "This Court has said that picketing is in part an exercise of the right of free speech guaranteed by the Federal Constitution (citing *Thornhill v. Alabama,* supra, and *American Federation of Labor v. Swing* (312 U. S. 321) and other cases). But *since picketing is more than speech* and establishes a locus in quo that has far more potential for inducing action or non-action than the message the pickets convey, this Court has not hesitated to uphold a state's restraining of acts and conduct which are an abuse of the right to picket rather than a means of peaceful and truthful publicity (citing cases)." (Emphasis supplied)

The U. S. Supreme Court answered its statement of the question in the affirmative and affirmed the injunction granted by the State of Washington Supreme Court.

In *Hughes v. Superior Court of Contra Costa County* (339 U. S. 460, 70 Sup. Ct. 718) (1950) the U. S. Su-

preme Court affirmed the right of the California Court to enjoin picketing for an unlawful purpose.

In another case decided in 1950, the U. S. Supreme Court in *International Brotherhood of Teamsters v. Hanke* (339 U. S. 470, 70 Sup. Ct. 773) (at Page 474) affirmed the doctrine that:

> "We must start with the fact that while picketing has an ingredient of communication it cannot dogmatically be equated with the constitutionally protected freedom of speech."

The case also arose in the State of Washington and the U. S. Supreme Court again affirmed the right of the State of Washington to restrain picketing and affirmed the conclusion of the State Court that (P. 477)

> "the conclusion seems irresistible that the union's interest in the welfare of a mere handful of members (of whose working conditions no complaint at all is made) is far outweighed by the interests of individual proprietors and the people of the community as a whole, to the end that little businessmen and property owners shall be free from dictation as to business policy by an outside group having but a relatively small and indirect interest in such policy."

Without belaboring the point further, it would appear that in the eyes of the United States Supreme Court "picketing is more than speech" and may be enjoined if unlawful or against the public policy of the State or Federal government.

B. The Purpose of the Picketing and Economic Pressure Herein Is Unlawful and Coercive.

The union representatie has admitted in his testimony that the purpose of the picketing was to force the employers to sign a union shop contract and thereby force the employees into the Union. (Tr. p. 83.)

The results of a National Labor Relations Board election in which the employees unanimously rejected the union are also a part of the record in this case. (General Counsel's Exhibit No. 4.)

The undisputed testimony is that the Union representative would not solicit membership in the Union by contacting the employees but on the contrary adopted the course of conduct which tried to force the union upon them by economic pressure. (Tr. p. 112.)

The only contract offered by the Union was introduced into evidence at the hearing (General Counsel's Exhibit No. 7) and contains the following clauses:

ARTICLE I

UNION RECOGNITION

> The Employer herewith recognizes and accepts Automotive Lodge #942 as the "sole" and exclusive colective bargaining agent for all employees engaged in the repair, maintenance, and service of automotive equipment, excluding only New and Used car salesmen, service salesmen, office employees, guards, and supervisors as defined in the Act.

ARTICLE III

UNION SECURITY

> All employees covered by this Agreement, as a condition of employment, shall become members of, and maintain membership in the Union on and after the 31st day following the beginning of such employment, or the effective date of this Agreement, whichever is the later.

which would require the employees to join the Union or seek other employment.

Under oath in the National Labor Relations Board hearing in Case No. 19-RM;169 held prior to the election, the Union representative testified that he represented none of the employees at the employer's plant. (Tr. pp. 63-64; Gneral Counsel's Exhibit No. 6.)

The union representative admitted that he had gone further than picketing in his endeavors to compel union membership. He admitted contacting the Governor of the State of Washington by telegram in an attempt to stop the employer from performing work on state vehicles. (Tr. p. 77, p. 80.) He admitted contacting the Spokane branch of the International Harvester Company for the purpose of discouraging International Harvester Company from sending work to the employer. (Tr. p. 79.) He admitted contacting the manager of the Rainier Brewery Company concerning work the employer was doing for that company and discouraging the manager from sending further work to the employer. (Tr. p. 81.)

It was stipulated by the parties that the employer was placed on the union "We do not patronize" list

and was so publicized by the local labor newspaper from the time the picketing began until the latest issue of the newspaper. (Tr. p. 76; p. 123.)

Many other instances of picketing and economic pressure could be cited from the record but these instances serve to show that the calculated plan of the union was and is:

(1) To disregard the choice of the employee as shown in the NLRB election.

(2) To coerce the employer to sign a union shop contract without regard for the employee's wishes.

(3) To coerce the employees through economic pressure to join the union in order to protect their jobs.

It is submitted that such activity is coercive, unlawful and should be enjoinable.

As will be shown the applicable statute of the State of Washington has been determined by the U. S. Supreme Court to condemn picketing of the type employed in the instant case. Although the statute of the State of Washington is not controlling in the present case it should be noted that it contains the same provisions as the National Labor Relations Act with respect to the right of employees to be free from coercion by either labor organization or employers in their choice of representatives. Revised Code of Washington 49.32.020 provides as follows:

"Although he (the individual unorganized worker) should be free to decline to associate with his fellows, it is necessary that he have full freedom of association, self-organization, and designation of representatives of his own choosing, to negotiate the terms and conditions of his em-

> ployment and that he be free from interference, restraint, or coercion of employers of labor, or their agents, in the designation of such representatives or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protections."

Since this statute, identical in substance to the provisions of Section 8(b)(A) and 8(b)(2) of the Act, has been interpreted by the U. S. Supreme Court as prohibiting the same type of picketing in other cases, in effect the U. S. Supreme Court has already ruled that such picketing is coercive and should be enjoined.

In the *Building Service Employees v. Gazzam* case the United States Supreme Court stated (Page 538):

> "Under the so-enunciated public policy of Washington, it is clear that workers shall be free to join or not to join a union, and that they shall be free from the coercion, interference, or restraint of employers of labor in the designation of their representatives for collective bargining. *Picketing of an employer to compel him to coerce his employees' choice of a bargaining representative is an attempt to induce a transgression of this policy,* and the State here restrained the advocates of such transgression from further action with like aim. To judge the wisdom of such policy is not for us; ours is but to determine whether a restraint of picketing in reliance of the policy is an unwarranted encroachment upon rights protected from state abridgement by the Fourteenth Amendment."

At Page 540 the U. S. Supreme Court said:

> "Here, as in *Giboney* (supra), the union was using its economic power with that of its allies to compel respondent to abide by union policy

rather than by the declared policy of the State. That state policy guarantees workers free choice of representatives for bargaining purposes. If respondent had complied with the petitioner's demands and had signed one of the tendered contracts and lived up to its terms, he would have thereby coerced his employees. The employees would have had no free choice as to whether they wished to organize or what union would be their representative. The public policy of Washington relied upon by the court below to sustain this injunction is an important and widely accepted one. The broad purpose of the Act from which this policy flows was to prevent unreasonable judicial interference with legitimate objectives of workers. But abuse by workers or organizations of workers of the declared public policy of such an Act is no more to be condoned than violation of prohibitions against judicial interference with certain activities of workers. We therefore find no unwararnted restraint of picketing here." (Emphasis supplied)

It should be noted that the "so-enunciated" public policy of the State of Washington referred to in the *Building Service Employees International Union v. Gazzam* case has remained unchanged since the decision in that case and is still contained in Revised Code of Washington 49.32.020, as quoted previously and was recently examined and affirmed again in the case of *Audubon Homes, Inc. v. Spokane Building and Construction Trades Council et al,* 298 Pacific II 1112. In that case the union had no members among the employees and the court enjoined what the union termed "organizational picketing." The court quoted with approval the rule laid down in the *Swenson v. Seattle Labor Council* case (set forth in this brief)

and also said (Page 150):

> "Although peaceful picketing is recognized as an exercise of the right of free speech and therefore lawful, it cannot be made the cover for concerted action against an employer in order to achieve an unlawful or prohibited objective or an objective which is contrary to the declared public policy of the state, citing *Vogt, Inc. v. International Brotherhood of Teamsters, Local 695, AFL,* 74 N. W. II 749, 29 Labor Cases #69747 (1956)."

The court also said (Page 149):

> *"It is not clear from the record whether the ultimate purpose of the picketing was to coerce plaintiff into having his employees join a union* or since defendants had not even approached plaintiff, to cut off plaintiff's building materials and thus force plaintiff's business to die on the vine. *In either event, the picketing was coercive and unlawful.* Citing *Fornili v. Auto Mechanics Local No. 297 of the International Association of Machinists,* 200 Washington 283, 93 Pacific II 422, 1 Labor Cases #18456 (1939)." (Emphasis supplied)

In another case arising in the State of Washington involving stranger picketing after a NLRB election the State of Washington Supreme Court stated in *Swenson v. Seattle Central Labor Council,* 27 Washington 2nd 193, 188 Pacific 2nd 873, 12 Labor Cases #63610 (1947), at Page 206:

> "The United States Supreme Court has, by these cases, established this rule: Peaceful picketing is an exercise of the right of free speech. Organized labor has the right to communicate its views either by word of mouth or by the use of placards. This is nothing more nor less than a method of persuasion. But when picketing ceases to be used for the purpose of persuasion—

> just the minute it steps over the line from persuasion to coercion—it loses the protection of the constitutional guaranty of free speech, and a person or persons injured by its acts may apply to a court of equity for relief. The facts in this case convince us that the picketing complained of did not constitute an exercise of free speech as contemplated by our founding fathers. . . . This was coercion."

As previously stated the State of Washington statute guarantees to the employees the same right to refrain from union organization as does the National Labor Relations Act. The Washington statute has been interpreted and applied by both the State court and the U. S. Supreme Court to prohibit picketing of the type employed in the present case being coercive. The decision of the U. S. Supreme Court in these cases should be controlling in the present case.

The public policy of the Federal government is found in the National Labor Relations Act. Section 1 of the Act states that:

> "It is hereby declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization and designation of representatives *of their own choosing,* for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection." (Emphasis supplied)

Section 7 of the Act set forth the rights of employees:

> "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively *through representatives of their own* choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and *shall also have the right to refrain from any or all such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).*" (Emphasis supplied)

It should be noted that the underlined portion of the section quoted, that is the "right to refrain," is the part added by Taft-Hartley amendments of the National Labor Relations Act of 1947.

In the Conference Report, House Report 510, issued June 3, 1947, 80th Congress, Pages 38 to 40 it was pointed out that:

> "Both the House bill and the Senate amendment in amending the National Labor Relations Act preserved the right under Section 7 of that Act of employees to self-organization to form, join, or assist any labor organization, and to bargain collectively through representatives of their own choosing and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection. The House Bill, however, made two changes in that section of the act. First, it was stated specifically that the rights set forth were not to be considered as including the right to commit or participate in unfair labor practices, unlawful concerted activities, or violations of collective bargaining contracts. *Second, it was specifically set forth that*

employees were also to have the right to refrain from self-organization, etc., if they chose to do so. . . . The second change made by the House bill in Section 7 of the act (which is carried into the conference agreement) also has an important bearing on the kinds of concerted activities which are protected by Section 7. *That provision, as heretofore stated, provides that employees are also to have the right to refrain from joining in concerted activities with their fellow employees if they choose to do so.* Taken in conjunction with the provisions of section 8(b)(1) of the conference agreement . . . wherein it is made an unfair labor practice for a labor organization or its agents to restrain or coerce employees in the exercise of rights guaranteed in Section 7, it is apparent that many forms and varieties of concerted activities which the Board, particularly in its early days, regarded as protected by the Act, will no longer be treated as having that protection, since obviously persons who engage in or support unfair labor practices will not enjoy immunity under the act." (Emphasis supplied)

Senator Taft's understanding and intent on the right of employees to refrain from joining a labor organization are found in 93 Congressional Record 4023 (4143 in Board published volume), 4017 (4137 in Board published volume), 4022 (4143 in Board published volume), and 4024 (4144 and 4145 of Board published volume). A perusal of these pages clearly demonstrates that the intent of Senator Taft was that the right to refrain from joining a labor organization was a protected right of the employee and any attempted coercion to defeat that right was an unfair labor practice. At page 4022 of Volume 93 of the Congressional Record Senator Taft said:

"If a man is invited to join a union its members ought to be able to persuade him to join, but if they should not be able to persuade him they should not be permitted to interfere with him, coerce him, and compel him to join the union. *The moment that such a man is threatened with losing his job if he does not join, it at once becomes an unfair labor practice.* Threats and coercion ought to become unfair labor practices on the part of a union."

At Page 4023 of Volume 93 of the Congressional Record Senator Pepper queried:

"Will the Senator not have to admit that there is no definition of coercion that will leave it clear as to what can be done and what cannot be done?"

Senator Taft replied:

"The Board has been defining those words for 12 years, ever since it came into existence. Its application to labor organizations may have a slightly different implication, but it seems to me perfectly clear that from the point of view of the employees the cases are parallel. *The effect of the bill is to include both labor union leaders and individual employers.*" (Emphasis supplied)

Again at Page 4023, Senator Taft said:

"Mr. President, let me point out that the amendment protects men who may not be members of unions at all. In fact, many of the cases of coercion are cases in which there never has been a certification of a union, cases in which a union is attempting to organize sends its representatives to the plant and coerces the employees to join that union."

At Page 4023 of Volume 93 of the Congressional Record Senator Taft in speaking of the specific case of *Hall Freight Lines, Inc.* (65 NLRB 397) said:

> "The main threat was, 'Unless you join our union, we will close down this plant, and you will not have a job.' *This was the threat, and that is coercion—something which they had no right to do.*" (Emphasis supplied)

Section 8(b)(1)(A) of the Act provides that it shall be unfair labor practice for a labor organization or its agents "to restrain or coerce employees in the exercise of the rights guaranteed in Section 7"—one of which rights is the right to refrain from joining a labor organization.

Section 8(b)(2) of the Act provides that it shall be unfair labor practice for a labor organization or its agents "to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a)(3)" (which relates to discrimination in regard to hire on tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization).

The violation of Section 8(b)(1)(A)—that is, the coercion of the employees in the exercise of the right to refrain from union membership, guaranteed in Section 7—lies in the attempts of the union either to put the employer out of business or to force him to sign a contract which would require all of the employees to join the Union. The Union admits that a very real attempt was made both by the use of pickets and requests to customers that they cease doing business with the employer. The union knew, the employees knew, and the employer knew that if the union succeeded in curtailing or destroying the employer's

business there would be no jobs for the employees. There was, therefore, a threat to the employees that if they did not join the union they would be back on the labor market if the union were successful.

The violation of Section 8(b)(2)—that is, the attempt to cause an employer to discriminate against an employee in order to encourage union membership—lies in the picketing and contacting of customers by the union in order to force the employer to sign a union shop contract against his employee's will. Had the employer signed the union ship contract he would have had to discharge the employees who did not choose to become union members within 30 days after the signing of the contract.

Section 8(a)(3) of the Act points up the fact that forcing an employer to sign a union shop contract against his employee's wishes was intended to be an unfair labor practice because it provides that the employer may sign a union shop contract "if such labor organization is the representative of the employees as provided in Section 9(a) . . . and has at the time the agreement was made or within the preceding twelve months received from the Board a notice of compliance with Sections 9(f), (9), and (b) and unless following an election held as provided in Section 9(c) within one year preceding the effective date of such agreement, the Board shall have certified that a majority of the employees eligible to vote in such election have voted to rescind the authority of such labor organization to make such an agreement." In

other words, the employer would be guilty of an unfair labor practice if he signed a union shop contract when the union was not the representative of his employees or if the union had been decertified as representative. Obviously, the present employer knew that the instant union did not represent his employees, because they had unanimously repudiated the union in an NLRB election. In the present case then, the union attempted to coerce the employer into committing an unfair labor practice by signing a union shop contract against his employees' express wishes, with all parties aware that such a union shop contract would result in discrimination against the employees who would be forced either to join the union or be discharged.

One case analogous to the present situation is that of Local 50, Bakery and Confectionery Workers International Union (AFL-CIO): Arnold Bakers, Inc.) and Arnold Bakers Employees Association, 115 NLRB No. 208, Case No. 2-CC-321, decided May 15, 1956. In that case, after a Board election, the Arnold Bakers Employees Association was certified as the representative of the employees. Local 50 continued to picket after the certification. The Board ordered the union to cease and desist. In arriving at a decision the Board considered the element of free speech and quoted with approval from *International Brotherhood of Electrical Workers v. NLRB* (341 U. S. 694, 19 Labor Cases #66348) where at pages 703 and 704 the Court held:

"To exempt peaceful picketing from the reach of Section 8(b)(4) would be to open the door to the customary means of enlisting the support of employees to bring economic pressure to bear on their employer. The Board quickly recognized that to do so would be destructive of the purpose of Section 8(b)(4)(A). It said, 'To find that peaceful picketing was not thereby prescribed would be to impute to Congress an incongruous intent to permit, through indirection, the accomplishment of an objective, which is forbade to be accomplished directly.' United Brotherhood of Carpenters, 81 NLRB 802, 811."

In the case of *NLRB v. Red Arrow Freight Lines,* 193 Federal II 979, (1952) the Fifth Circuit Court of Appeals said (P. 981):

"This chapter (referring to Section 7 of the Act) was enacted to protect not the rights of unions to obtain representation contracts but rights of employees to be represented by a bargaining agent of their own choosing and such rights must be protected and preserved."

In the case of *NLRB v. Thompson Products,* 162 Federal II 287, (June 5, 1947) at Page 293 the court quoted *DeBardeleben v. NLRB,* 135 Federal II, 13, 15:

"*It cannot be too often stated that the purpose of the act is to leave the employees with a free choice. It is not to subject them to the compulsion of their employer, outside labor unions, the National Labor Relations Board or anybody else,* as to what is their best interest in joining or forming labor organization. Because this is so, it cannot be too often stated by the courts that the fact that workers choose unaffiliated associations is in itself no evidence whatever that those associations are not 'genuine unions' or that the

choice is dominated, interfered with or coerced." (Emphasis supplied)

In the case of *Capital Service, Inc. v. NLRB,* 204 Federal II 848, 23 Labor Cases #67615 decided May 12, 1953, the Ninth Circuit Court of Appeals pointed out that:

> "That the Board has sometimes, in enforcement cases, overlooked the possibilities of Section 8(b)(1)(A) is suggested by what was said in *Labor Board v. Rice Milling Company,* 341 U. S. 665 at page 672, 19 Labor Cases #66346. The Board should be vigilant to see that what was sauce for the goose under the Wagner Act is now sauce for the gander under the Taft-Hartley Act. Nothing could more strongly restrain Services' employees from retaining their non-union status or coerce them into joining the Bakery Union than stopping or making intermittent their employment by picketing with appeals to persuade the public to boycott the products of their work. . . . Here is more than an appeal to the employees to persuade their action. Here is successful economic coercion tending to prevent them from exercising their right to work, by diminishing the public consumption of the product of their work."

The Court then quoted Senator Taft's statements during debate concerning the Act to demonstrate that the intent of the Taft-Hartley Act was to prevent coercion as exercised in the instant case.

A recent National Labor Relations Board decision on the same subject is contained in the case of *Drivers, Chauffeurs and Helpers Local 639, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Curtis Bros.,*

Inc. (119 NLRB No. 33), decided October 30, 1957. The opinion states:

> "The realities of our industrial life, lead inescapably to the fact that picketing by its very nature is a signal to all who may approach the picket line or who may work behind it. As the Supreme Court said, the very presence of a picket line may induce action of one kind or another 'quite irrespective of the nature of the ideas being disseminated.' In one case, the object of the picketing may be to prevail upon the employer to change his wage scale; in another to negotiate working conditions with the union instead of with his employees individually. In either event, the purpose of the picketing is to exert a pressure upon the employer after attempts at oral perspasion have failed. But the pressure is necessarily an economic one, a device to reduce the business to the point where his financial losses force him to capitulate to the union's demands. It is immaterial whether the ostensible technique, or the unspoken but necessary consequence, is to cut off the employer's labor supply by preventing the employees from reporting to work; to keep the customers from buying his products; or to interrupt deliveries of supplies to the premises. The important fact of the situation is that the Union seeks to cause economic loss to the business during the period that the Employer refuses to comply with the Union's demands. *And the employees who choose to continue working, while the union is applying this economic hurt to the employer, cannot escape a share of the damage caused to the business on which their livelihood depends. Damage to the employer during such picketing is a like damage to his employees.. That the pressure, thus exerted upon the employees—depriving them of the opportunity to work and be paid—is a form of coercion cannot be gainsaid.*

There is nothing in the statutory language of Section 8(b)(1)(A) which limits the intendments of the words 'restrain or coerce' to direct application of pressure by the Respondent Union of the employees. The diminution of their financial security is not the less damaging because it is achieved indirectly by a preceding curtailment of the employer's interests." (Emphasis supplied)

A more recent decision of the National Labor Relations Board which holds that such picketing is coercive and enjoinable is the case of *General Teamsters, Packers, Food Processors and Warehousemen Union Local No. 912, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, et al v. H. A. Rider and Sons* (120 N.L. R.B. No. 199), decided June 23, 1958.

Surely, if the Board protects the decision of employees to choose their own association as bargaining representative, it should protect the decision of employees to bargain directly with their employer as in the instant case.

From a consideration of the National Labor Relations Act, itself, the legislative history of the Act, and the cases dealing with picketing after an NLRB election, it would appear that the public policy of the Federal government coincides with the public policy of the State of Washington in forbidding coercive picketing as conducted in the instant case.

C. Reason and Logic Support the Rule That Picketing After Repudiation In a National Labor Relations Board Election and Picketing for a Union Shop Contract In the Absence of Being Certified as Bargaining Representative IS Coercive and Prohibited Under Sections 8(b)(1)(A) and 8(b)(2) of the Act.

Section 9 of the Act is concerned primarily with procedure to establish representation of the employees. Section 8(b)(4)(c) of the Act makes it an unfair labor practice for a union to force an employer to recognize or bargain with a labor organization if another labor organization has been certified as the representative of the employees under the provisions of Section 9 of the Act. Section 8(a)(3) of the Act makes it an unfair labor practice for an employer to enter into a union shop contract against his employees' wishes unless the contract is with a union certified by the NLRB as representative of the employees. One stated purpose of the act is to protect the rights of employees. Surely these provisions must have some meaning.

Of what value is an election procedure if it has no effect? In the instant case the employees freely chose not to be represented by the Union. Their freedom of choice would be protected if they had chosen another union or had chosen their own association. Is it lawful for both the employees and the employer to be subjected to picketing and economic pressure because the employees chose to bargain directly with

their employer? Since Section 7 of the Act grants freedom of choice to the employees is it to be enforced or may it be ignored so as to frustrate one primary purpose of the Act?

Clearly this is not a case where the Union is seeking to perform a service for the employees. The employees have clearly indicated by their unanimous choice that they do not wish to be represented by the union. To allow the union to continue picketing and economic pressure would be to abandon the employees' rights and the employer's rights to the law of the jungle, the law that hold that might makes right.

The National Labor Relations Board has established as a general rule in several cases (*Eclipse Lumber Co.,* (1951) 95 NLRB 464; *Lane v. NLRB,* (CA 10; 1951) 19 Labor Cases #66112, 186 Federal II 671; *Newman d.b.a. H. M. Newman,* (1949) 85 NLRB 725; *Mundet Cork Corporation,* (1951) 96 NLRB 1142; *Pinkerton's National Detective Agency, Inc.,* (1950) 90 NLRB 205; *Smith Cabinet Manufacturing Company,* (1949) 81 NLRB 460) that threats of loss of employment by union representatives which are "reasonably calculated" to have an effect on the listener without regard to the union's ability to carry them out, are violative of the Act. The concerted plan of the union was to put such economic pressure on the employer as was necessary to force the employer to sign a union shop contract against his employees' wishes or to force him out of business. This threat of curtailed operations or cessation of business was a very

real threat to the employees. *The hard facts were that the employees would either be forced into the union or out of employment.* Surely if the employer had threatened the employees with loss of employment if they chose to join the union, he would be guilty of coercion. As Senator Taft stated:

> "The Act for years has contained the provision: 'It shall be an unfair labor practice on the part of an employer' . . . 'To interfere with, restrain, or coerce employees in the exercise of the rights to work and organize.' *All that is attempted is to apply the same provision with exact equality to labor unions,"* (Legislative History of Labor Management Relations Act, 1947, Volume 2, 1207, quoted in *Capital Services, Inc. v. NLRB,* 204 Federal II 848, 23 Labor Cases #67615). (Emphasis supplied)

If the Board does not restrain the picketing and economic pressure in this instance what course of action is open to the employer? Apparently he may continue to operate for as long as possible in the face of picketing, publication in the labor newspaper as being "unfair to organized labor," and attempts by the Union to persuade his customers to deal elsewhere. The Union representative has testified that such tactics will continue until the Board orders them stopped or until he "retires." (Tr. P. 74.) The employer's resources are limited, the union's resources are practically unlimited. The employer, if successful, will suffer the loss of thousands of dollars. If the employer is unsuccessful he may either sign a union shop contract against his employee's express wishes or quit business. If the employer signs a union shop

contract against his employees' wishes he is guilty of an unfair labor practice. If the employer quits business the employees lose their employment. Is this the intent of the Act?

CONCLUSION

Picketing may be prohibited if shown to be for an unlawful purpose. The picketing in this case is for an unlawful purpose because it is contrary to the public policy of the State of Washington and the Federal government as enunciated by statute and case law. The intent and purpose of the National Labor Relations Act is thwarted and frustrated if the freedom of choice of the employees is not protected from coercive action directed against the employees and the employer. Such coercive action directly violates Sections 8(b)(1)(A) and Sections 8(b)(2) of the Act because it is a direct attempt to restrain or coerce employees in the exercise of the rights guaranteed in Section 7 of the Act and because it is a direct attempt to cause an employer to discriminate against the employees in violation of Section 8(a)(3) of the Act by attempting to force the employer to sign a union shop contract against the unanimous wishes of his employees. As a matter of law, justice, and public policy the employer respectfully requests that the Court of Appeals enforce the order of the National

Labor Relations Board restraining the Union from picketing, contacting the employer's customers to discourage them from sending work to the employer, and claiming that the employer is "unfair to organized labor."

Respectfully submitted,

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Attorneys for Amicus Curiae.

No. 15814

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD, *Petitioner*

v.

INTERNATIONAL ASSOCIATION OF MACHINISTS, LODGE 942, AFL-CIO, *Respondent*

On Petition for Enforcement of an Order of the National Labor Relations Board

---

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

This case is before the Court upon the petition of the National Labor Relations Board to enforce its order (R. 24-26) issued against the International Association of Machinists, Lodge 942, AFL-CIO, hereafter called the Union, on November 4, 1957, following the usual proceedings under Section 10(c) of the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C., Sec. 151, *et seq.*).

STATEMENT OF THE CASE

The Board found that the Union engaged three forms of activity: (1) For nearly a year from August 16, 1955 to July 13, 1956, except for a four to six week interval during the winter of 1955-1956, the Union peacefully picketed the premises of Alloy Manufacturing Company. The picketing was carried on by a single person. The picket sign originally read "This firm is Nonunion" and was later changed to read "Nonunion employees unfair." (R. 39; 70, 73-75, 106-107, 108.) (2) On June 20, 1955, the Union wrote to the Spokane Central Labor Council requesting that Alloy be placed on the Council's "We Do Not Patronize" list. On July 27, the Council placed Alloy on the list. The list is published in the "Labor World," the official periodic publication of the Council. (R. 37, 38; 58, 71, 76, 115-116, 122-123.) (3) The Union asked several of Alloy's customers not to patronize Alloy (R. 21, 39-40; 79-82).

The Board found that the Union carried on this three-faceted activity for the purpose of inducing Alloy (1) to recognize the Union as the exclusive representative of its employees, and (2) to enter into a union shop agreement with it (R. 19, 20, 23-24, 52). The Board also found that the Union did not represent a majority of Alloy's employees (*ibid.*). The Board concluded, based on its finding that the Union sought exclusive recognition when it had no majority, that by each of the three separate facets of its activity—the picketing, the "We Do Not Patronize" list, and the customer appeals—the Union violated Section 8(b)(1)(A) of the Act (R. 19, 23-24). Section 8(b)(1)(A) provides that it shall be an unfair labor practice for a labor organization or its agents "to restrain or coerce employees (A) in the exercise of the rights guaranteed in section 7. . . ." Section 7 provides that:

> Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain

> collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).

The Board further concluded, based on its finding that the Union sought a union shop agreement when it had no majority, that by each of the three separate facets of its activity the Union independently violated Section 8(b)(2) and(1)(A) of the Act (R. 19-20, 52). Section 8(b)(2) provides that it shall be an unfair labor practice for a labor organization or its agents "to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a)(3). . . ." Section 8(a)(3) makes it an unfair labor practice for an employer to encourage or discourage membership in a labor organization by discrimination in employment, and *inter alia* excepts a union shop agreement from its scope if the "labor organization is the representative of the employees as provided in section 9(a), in the appropriate collective-bargaining unit covered by such agreement when made. . . ."

The Board's order requires the Union to cease and desist from (1) "Restraining or coercing employees of Alloy . . . in the exercise of the rights guaranteed in Section 7 of the Act", and (2) "Attempting to cause Alloy, by means of picketing or by threatening to divert business from Alloy, to discriminate against Alloy's employees in violation of Section 8(a)(3) of the Act" (R. 24-25). The Union is also required to post notices (R. 25).

SUMMARY OF ARGUMENT

I

Picketing to secure the recognition of a minority union does not violate Section 8(b)(1)(A) of the Act.

A. Section 8(b)(4)(C) of the Act is the key to the invalidity of the Board's interpretation of Section 8(b)(1)(A). By Section 8(b)(4)(C) Congress has expressed the sole extent to which it intends to regulate as an unfair labor practice picketing by a union of an employer to secure that employer's recognition of it as the representative. And by Section 8(b)(4)(C) Congress has restricted such picketing for recognition only in the situation where *another* union has been *certified* by the Board as the representative of the employees. To prohibit picketing for recognition in any other situation, as the Board by its interpretation of Section 8(b)(1)(A) does, is to embrace a purpose which Congress has deliberately renounced.

B. If Section 8(b)(4)(C) means what it says, then Section 8(b)(1)(A) cannot mean what the Board holds. The two indeed have separate functions which do not overlap. Section 8(b)(4) is concerned with the "end sought," with defining "proscribed objectives." *International Brotherhood of Electrical Workers* v. *N.L.R.B.*, 341 U.S. 694, 702; see also *id.* at 704. By Section 8(b)(1)(A), on the other hand, "Congress was aiming at means, not end." *Perry Norvell Co.*, 80 NLRB 225, 239. "By Section 8(b)(1)(A), Congress sought to fix the rules of the game, to insure that strikes and other organizational activities of employees were conducted peaceably by persuasion and propaganda and not by physical force, or threats of force, or of economic reprisal." *Ibid.* When the Board interprets Section 8(b)(1)(A) to prohibit peaceful picketing, because its *purpose* is to secure the recognition of a minority union, it transforms Section 8(b)(1)(A) from a provision designed to curb picketing, when conducted by coercive

means, into an instrument to curb picketing, however peaceful, because of the end it furthers. This fundamentally alters the function of Section 8(b)(1)(A) within the statutory scheme.

C. The Board's construction of Section 8(b)(1)(A) conflicts with Sections 8(c) and 13; it reverses a long-standing interpretation; and it renders Section 8(b)(4)(C) redundant.

1. Section 8(c) protects, and peaceful picketing constitutes, the "expressing" and "dissemination" of "views, argument, or opinion" "in written, printed, graphic, or visual form." The Supreme Court's decision in *Electrical Workers* v. *N.L.R.B.*, 341 U.S. 694, confirms the exemption of peaceful picketing from the reach of Section 8(b)(1)(A) and the applicability of Section 8(c) to guarantee is immunity.

2. "By § 13, Congress has made it clear that * * * all * * * parts of the Act which otherwise might be read so as to interfere with, impede or diminish the union's traditional right to strike, may be so read only if such interference, impediment, or diminution is 'specifically provided for' in the Act." *N.L.R.B.* v. *International Rice Milling Co.*, 341 U.S. 665, 673. There is nothing in Section 8(b)(1)(A) which "specifically" provides for the impairment of the right to strike and picket which the Board would effect. See *Mastro Plastics Corp.* v. *N.L.R.B.*, 350 U.S. 270, 284. Little indeed would be left of the right to strike if the right to picket were not protected as an inseparable part of it (*Schultz Refrigerated Service, Inc.*, 87 NLRB 502, 504-505), and for that reason section 13 cloaks both (*Sales Drivers Union* v. *N.L.R.B.*, 229 F. 2d 514, 517-518, cert. denied, 351 U.S. 972).

3. By its present construction of Section 8(b)(1)(A), adopted late in 1957, the Board overturns a settled and uniform interpretation first made in 1948, within a year of the effective date of the Taft-Hartley amendments in

1947, and undeviatingly adhered to for nine years. "At this late date the courts ought not to uphold an application of the law contradictory of this settled administrative interpretation." *United States* v. *Chi. N.S. & Mil. R. Co.,* 288 U.S. 1, 13-14. This is peculiarly true here where the overturned interpretation involves a "contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new." *United States* v. *American Trucking Ass'ns.,* 310 U.S. 534, 549, quoting from *Norwegian Nitrogen Co.* v. *United States,* 288 U.S. 294, 315.

4. Section 8(b)(4)(C) of the Act "has no place in this Statute if Section 8(b)(1)(A) can be interpreted broadly to forbid picketing by a minority labor organization for recognition. For the type of picketing prohibited by Congress in Section 8(b)(4)(C) necessarily is in the category now forbidden under Section 8(b)(1)(A). Thus, through administrative interpretation of one provision, the specific language of another statutory provision in this Act has been reduced to a useless gesture."[1] It goes without saying that "We are not at liberty to construe any statute so as to deny effect to any part of its language." *Washington Market Co.* v. *Hoffman,* 101 U.S. 112, 115-116.

D. "It is relevant to recall that the Taft-Hartley Act was, to a marked degree, the result of conflict and compromise between strong contending forces and deeply held views on the role of organized labor in the free economic life of the Nation and the appropriate balance to be struck between the uncontrolled power of management and labor to further their respective interests. This is relevant in that it counsels wariness in finding by construction a broad policy . . . as such when, from the words of the statute itself, it is clear that those interested in just such

[1] Member Fanning dissenting in *Paint, Varnish & Lacquer Makers Union, Local 1232,* 120 NLRB No. 89, sl. op. p. 10, 42 LRRM 1195, 1197.

a condemnation were unable to secure its embodiment in enacted law." *Local 1976, United Brotherhood of Carpenters* v. *N.L.R.B.*, 357 U.S. 93, 99-100. The Board in this case has isolated a single principle, pushed it to a logical extreme, and reached a determination which Congress, fully ware of the whole range of the problem and the opposing claims and interests with which it bristles, has deliberately refrained from embracing. It is no part of the function of the Board to be "a super-Congress."[2]

II

Even if picketing to secure the recognition of a minority union is a violation of Section 8(b)(1)(A), the appeals to customers not to patronize the employer, and the request that the employer be placed on a "We Do Not Patronize" list, are not. An appeal for consumer support is not proscribed under any provision of the Act. It is affirmatively protected by Section 8(c). And it is within the Constitution's guarantee of freedom of expression.

III

Except for the finding that the Union violated Section 8(b)(2) of the Act by picketing to secure a union shop agreement when it had no majority, the remaining bases upon which the Board found statutory violations on the Union's part are without merit. The only additional feature relevent to these alleged violations is that the union sought entry into a union shop agreement when it had no majority. This adds nothing to recognition of a minority union. Both are a legally insufficient basis for finding a violation of either Section 8(b)(1)(A) or 8(b)(2).

IV

Upon the assumption that the Board properly found a violation of Section 8(b)(1)(A) of the Act, its order is

[2] *N.L.R.B.* v. *National Maritime Union*, 175 F. 2d 686, 691 (C.A. 2), cert. denied, 338 U.S. 954.

too broad in providing a blanket prohibition against "Restraining or coercing employees of Alloy Manufacturing Company in the exercise of the rights guaranteed in Section 7 of the Act" (R. 24). So uncircumscribed an order is at war with the principle that "To justify an order restraining other violations it must appear that they bear some resemblance to that which the . . . [wrongdoer] has committed or that danger of their commission in the future is to be anticipated from the course of his conduct in the past." *N.L.R.B.* v. *Express Publishing Co.,* 312 U.S. 426, 437.

ARGUMENT

The Board found that the Union used three means to gain two objectives. The Union picketed, requested that Alloy be placed on the "We Do Not Patronize" list, and asked several of Alloy's customers not to patronize it, all for the purpose of inducing Alloy to recognize the Union as the exclusive representative and to enter into a union shop agreement with it. The central vice found by the Board in this conduct is that the Union did not represent a majority of Alloy's employees. The Board found that, insofar as the Union sought exclusive recognition and a union shop agreement, each objective constituted a separate basis for finding a violation of Section 8(b)(1)(A) of the Act. And, insofar as the Union sought a union shop agreement, the conduct independently violated Section 8(b)(2) of the Act. The Board did not differentiate among the means employed by the Union, blanketing the customer appeals and the "We Do Not Patronize" list with picketing, and illegalizing them all.

Each facet of the activity, while entailing overlapping elements, also presents to a significant degree different considerations. It will therefore facilitate analysis to treat each constituent part of the conduct separately. We begin with picketing to secure the recognition of a minority union, found by the Board to violate Section 8(b)(1)(A) of the Act.

I. PICKETING TO SECURE THE RECOGNITION OF A UNION WHICH DOES NOT REPRESENT A MAJORITY DOES NOT VIOLATE SECTION 8(b)(1)(A) OF THE ACT.

A. Section 8(b)(4)(C) of the Act Expresses the Sole Extent to Which Congress Intended to Regulate as an Unfair Labor Practice Picketing by a Union of an Employer to Secure That Employer's Recognition of It as the Representative.

Section 8(b)(4)(C) of the Act is the key to the invalidity of the Board's interpretation of Section 8(b)(1)(A). By Section 8(b)(4)(C) Congress has expressed the sole extent to which it intends to regulate as an unfair labor practice picketing by a union of an employer to secure that employer's recognition of it as the representative. And by Section 8(b)(4)(C) Congress has restricted such picketing for recognition only in the situation where *another* union has been *certified* by the Board as the representative of the employees. To prohibit picketing for recognition in any other situation, as the Board by its interpretation of Section 8(b)(1)(A) does, is to embrace a purpose which Congress has deliberately renounced.

Thus, Section 8(b)(4)(C), newly enacted in 1947, provides that it shall be an unfair labor practice for a labor organization or its agents to engage in, or to induce or encourage the employees of any employer to engage in, a strike or a concerted refusal to work, "where an object thereof is":

> forcing or requiring any employer to recognize or bargain with a particular labor organization as the representative of his employees if another labor organization has been certified as the representative of such employees under the provisions of Section 9.

Prohibiting inducement or encouragement of employees to strike of course forbids peaceful picketing directed to the employees to influence them to engage in a work stoppage.[3]

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[3] *International Brotherhood of Electrical Workers* v. *N.L.R.B.*, 341 U.S. 694, 700-705.

Equally clearly, however, to strike or picket for recognition is forbidden only where another union has been certified as the representative.[4] As the Senate Report states (S. Rep. No. 105, 80th Cong., 1st Sess., 22, in 1 Leg. Hist. 428):

> It is to be observed that the primary strike for recognition (*without* a Board certification) is *not* proscribed. (Emphasis supplied.)

In virtually identical terms, the House Conference Report states (H. Conf. Rep. No. 510, 80th Cong., 1st Sess., 43, in 1 Leg. Hist. 547):

> It is to be observed that the primary strike for recognition (*without* a Board certification) was *not* prohibited. (Emphasis supplied.)

Congress thus restricted itself to a single narrow area of recognitional activity, namely, "Strikes and boycotts having as their purpose forcing any employer to disregard his obligation to recognize and bargain with a certified union and in lieu thereof to bargain with or recognize another union. . . ."[5]

Predecessor versions of Section 8(b)(4)(C) embraced much broader prohibitions. The House bill, as reported and passed,[6] and an early version of the Senate bill,[7] prohibited "any strike or other concerted interference with

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[4] See, H. Conf. Rep. No. 510, 80th Cong., 1st Sess., 44, in 1 Leg. Hist. 548; S. Rep. No. 105, 80th Cong., 1st Sess., 22, in 1 Leg. Hist. 428; 93 Cong. Rec. 1844, 1846, 4905, in 2 Leg. Hist. 981-982, 986, 1455; 93 Cong. Rec. 136; 5 *Hearings before Committee on Education and Labor, House of Representatives, on Bills to Amend and Repeal the National Labor Relations Act,* 80th Cong., 1st Sess., 3161-62; 4 *Hearings before the Committee on Labor and Public Welfare, United States Senate, on S. 55 and S. J. Res. 22,* 80th Cong., 1st Sess., 1905.

[5] H. Conf. Rep. No. 510, 80th Cong., 1st Sess., 44, in 1 Leg. Hist. 548; S. Rep. No. 105, 80th Cong., 1st Sess., 22, in 1 Leg. Hist. 428.

[6] H.R. 3020, 80th Cong., 1st Sess., Sec. 12(a)(3)(C), in 1 Leg. Hist. 79, 205; see also H. Rep. No. 245, 80th Cong., 1st Sess., 44; H. Conf. Rep. No. 510, 80th Cong., 1st Sess., 59; both in 1 Leg. Hist. 335, 563.

[7] S. 360, 80th Cong., 1st Sess., Sec. 13(b) (January 27, 1947).

an employer's operations, an object of which is (i) to compel an employer to recognize for collective bargaining a representative not certified under Section 9 as the representative of the employees, or (ii) to remedy practices for which an administrative remedy is available under this Act, or (iii) to compel an employer to violate any law or any regulation, order, or direction issued pursuant to any law." This proposal banned any recognition strike or picketing except where the labor organization was certified by the Board as the exclusive bargaining representative. In its ultimate evolution, this total ban of any recognition strike or picketing, except in support of the status of a certified union, was narrowed to its present form, which prohibits a recognition strike or picketing only if another union has been certified. Thus, instead of preconditioning the validity of a recognition strike or picketing upon the existence of a certification of the striking or picketing union, Congress did the reverse; it preconditioned the validity of such a strike or picketing solely upon the absence of certification of another union. As a matter of deliberate choice, therefore, except for the narrowly defined activity regulated by Section 8(b)(4)(C), Congress left unrestricted the right of a labor organization to engage in a recognition strike or picketing.

This was fully recognized and endorsed by the Joint Committee on Labor Management Relations. This committee, in the discharge of its function to study and investigate "the administration and operation of existing Federal laws relating to labor relations" (Title IV, Sec. 402(7), Labor Management Relations Act, 1947), reported concerning strikes for recognition (Com. Print., Rep. No. 986, Part 3, 80th Cong., 2nd Sess., 70-71):

> Both the bills passed by the House of Representatives in 1947[8] and early committee versions of the

[8] H.R. 3020, 80th Cong., 1st Sess., Sec. 12(a)(3)(C)(ii), in 1 Leg. Hist. 205-206.

Senate bill[9] contained some form of prohibition against a strike for a purpose for which the act provided an administrative remedy. Such a provision would have prohibited a strike for recognition, since the labor organization has available the certification processes of the Board. *The Taft-Hartley law's only limitation upon such strikes is that provided by Section 8(b)(4)(C). The right to strike for recognition is only foreclosed when another labor organization has been certified as the bargaining representative.* (Emphasis supplied.)

A labor organization may lose an election in which it was the only union on the ballot and the next day call a legal strike to force the employer to recognize it as the bargaining agent for those employees who have just rejected it. A number of instances have just been called to the committee's attention (hearings, p. 267). (Emphasis supplied.)

Many labor organizations have enjoyed recognition by, and contracts with, employers without ever having been certified by the Board. The employers have not first required such unions to prove their majority status in an election conducted by the Board, being satisfied to rely upon a check of membership cards, dues records, or other proof that they were the choice of the majority of the employees. A union seeking to supplant one of these uncertified bargaining representatives may call a strike for such purpose without violating Section 8(b)(4)(C). This was the situation in the recent *Perry Norvel Co.*, Case (9-CB-3) [80 NLRB 225], in which an uncertified union held a contract with the employer and another union struck for bargaining rights.

Present law in no way limits the primary strike for recognition except in the face of another union's certification. It has frequently been suggested that Section 8(b)(4)(C) should be broadened to cover the situations where another union has been recognized, or has a contract, and where the striking union has failed to win recognition at the ballot box. A fairly good case can be made for such an amendment. It would not

[9] S. 360, 80th Cong., 1st Sess., Sec. 13(b)(2) (January 27, 1947).

go as far as the suggestion prohibiting strikes for purposes for which the law provides an administrative remedy, for the union seeking bargaining rights in an unorganized shop might still strike for it. (Emphasis supplied.)

There are two factors which might be considered in connection with any further restrictions upon recognition strikes. The first is the time element involved in acquiring bargaining rights by the orderly procedure provided by the act. If the employer will not consent to an election, it now requires an average of 84 days to dispose of a representation case (hearings, p. 1138). It may be questioned whether or not the mere availability of an administrative remedy is sufficient to restrict the right to strike. Perhaps the remedy should be prompt as well as available.

A second consideration arises out of the fact that Section 9(c)(3) limits elections to one in a given year. A labor organization which loses an election and strikes for recognition the next day or the next week may be condemned for such action, but there may be equities militating against it having to wait a whole year. The situation may arise where some action by the employer, or a more successful organizing campaign, causes the union to acquire an overwhelming majority within a few weeks following an election in which it has been rejected by the employees.

The committee believes that further experience with the act is advisable before consideration is given to broadening Section 8(b)(4)(C).

The report thus recognizes that (1) "Present law in no way limits the primary strike for recognition except in the face of another union's certification"; and (2) "A labor organization may lose an election in which it was the only union on the ballot and the next day call a *legal* strike to force the employer to recognize it as the bargaining agent for those employees who have just rejected it." (Emphasis supplied.)

There can be no question of the validity of the report of the Joint Committee as an authoritative expression of the

congressional purpose. The Supreme Court has relied upon it at least four times. *United Mine Workers* v. *Arkansas Oak Flooring Co.,* 351 U.S. 62, 75, n. 14; *N.L.R.B.* v. *Lion Oil Co.,* 352 U.S. 282, 288 and n. 5, and concurrence at 299-300; *Gus* v. *Utah Labor Relations Board,* 353 U.S. 1, 9, n. 15, and dissent at 14 and n. 3, 15, n. 7; *American Newspaper Publishers Association* v. *N.L.R.B.,* 345 U.S. 100, 108, n. 8. The Supreme Court has quoted with approval that report's observation that "Present law in no way limits the primary strike for recognition except in the face of another union's certification." *United Mine Workers* v. *Arkansas Oak Flooring Co., supra.* It has observed that "the Joint Committee of Congress [was] created by the very act" which is the subject of its report "to study the operation of the federal labor laws." *N.L.R.B.* v. *Lion Oil Co., supra.* The Court of Appeals for the Sixth Circuit, after careful consideration of the reasons for the creation of the Joint Committee and the circumstances of its operation (188 F. 2d at 921-924),[10] considered its report "illuminating" (*id.* at 921) and "persuasive evidence" (*id.* at 923) of congressional intent. *N.L.R.B.* v. *Wiltse,* 188 F. 2d 912, 921-924 (C.A. 6), cert. denied, 342 U.S. 859. See also *Herzog* v. *Parsons,* 181 F. 2d 781, 788 (C.A.D.C.), cert. denied, 340 U.S. 810.

The report of the Joint Committee closed with the observation that "The committee believes that further experience with the act is advisable before consideration is given to broadening Section 8(b)(4)(C)" (*supra,* p. 13). Thus far experience has not led Congress to enlarge its scope.

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[10] Among other things, the Sixth Circuit noted that (188 F. 2d at 923):

> "Congress . . . was deeply concerned with the manner in which the amended Act would operate and, accordingly, . . . the Act provided for the Joint Congressional Committee to carry on a continuing thorough study and investigation of labor-management relations, including the administration of the federal laws relating to labor relations, with the object of reporting back to Congress the results of its investigation, together with recommendations for further legislation on the subject. Among the members of such Joint Congressional Committee, it is to be noted, were Senator Taft and Representative Hartley, authors and sponsors of the Labor-Management Relations Act which bore their name."

Indeed, in the 85th Congress which has just adjourned a strenuous effort was made and defeated to expand the prohibition of recognition picketing. And in virtually every Congress since the 80th Congress which passed Section 8(b)(4)(C) bills to broaden it have been introduced but unenacted.[11]

Thus, on January 23, 1958, President Eisenhower presented his message to the 85th Congress recommending new labor legislation. Included among his recommendations was a proposal to (41 LRRM 78, 81):

> Amend the Act to make it an unfair labor practice for a union, by picketing, to coerce an employer to recognize it as the bargaining representative of his employees or his employees to accept or designate it as their representative where:
>
> The employer has recognized in accordance with law another labor organization:
>
> The employees, within the last preceding twelve months, have rejected the union in a representative election; or
>
> It is otherwise clear that the employees do not desire the union as their bargaining representative.

Immediately following the President's message, S. 3099 (January 23, 1958), H.R. 10248 (January 23, 1958), and H.R. 10273 (January 27, 1958) were introduced, and Section 4 thereof provided that Section 8(b) of the Taft-Hartley Act be amended to make it an unfair labor practice for a labor organization or its agents:

> (1) to picket or cause to be picketed, or threaten to picket or cause to be picketed, any employer with the object of forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees, or forcing or requiring the employees of an employer to accept or select such labor organization as their collective bargaining representative:

[11] We set these bills out in the Appendix, *infra*, pp. 60-61.

(A) where the employer has recognized in accordance with this Act any other labor organization and a question concerning representation may not appropriately be raised under section 9(c) of this Act, or

(B) where within the preceding 12 months a valid election under section 9(c) of this Act has been conducted, or

(C) where the labor organization cannot establish that there is a sufficient interest on the part of the employees in having such labor organization represent them for collective bargaining purposes, or

(D) where such picketing has been engaged in for a reasonable period of time and at the expiration of such period an election under section 9(c) has not been conducted.

In introducing S. 3099, Senator Smith explained with respect to this feature of it that (104 Daily Cong. Rec. 1137 (Jan. 30, 1958)):

> The bill would also amend the National Labor Relations Act so as, *for the first time,* to deal specifically with organizational and recognition picketing. Such picketing has been generally criticized and there are many who would prohibit it completely. The bill would not do this but it would restrict picketing to force organization or recognition to situations where the employees in question have evidenced sufficient interest in having the union as their bargaining representative and even then would permit it only for a reasonable period of time within which a representative election would have to be conducted. (Emphasis supplied.)

But the bill which reached the floor of the Senate for a vote, S. 3974 entitled "Labor-Management Reporting and Disclosure Act of 1958," did not contain the Administration's proposed restriction upon recognition picketing. And so on June 12, 1958, Senator Smith introduced an amendment to S. 3974 providing the identical limitation upon recognition picketing which he had theretofore intro-

duced as S. 3099 (quoted above). 104 Daily Cong. Rec. 9897-98 (June 12, 1958). This was number one of eighteen amendments then introduced by Senator Smith on behalf of the Administration to correct alleged defects in S. 3974. *Id.* at 9902. In describing the amendment pertaining to recognition picketing, Senator Smith stated (*id.* at 9898):

> The proposed amendment would restrict organizational or recognition picketing to those situations in which the union can show a sufficient interest on the part of the employees in being represented by it and would restrict the duration of such picketing to a reasonable period of time during which a representation election would have to be conducted to determine the employees' wishes as to a collective bargaining representative. The determination of sufficient interest and reasonable period of time would rest with the National Labor Relations Board.

But Senator Smith "decided not to bring up" this and other amendments "because of the obvious impossibility of their passage. These proposals of the administration will await further consideration at some future time." 104 Daily Cong. Rec. 10374 (June 17, 1958). In a statement of supplemental views, Senator Smith, together with Senators Goldwater, Purtell and Allott, noted that "We regret that no attempt was made to remedy the long-standing deficiencies and weaknesses in the present law. We refer to [among others] . . . organizational and recognitional picketing against the wishes of the employees. . . ." *Id.* at 10373. And in like tenor Senator Johnston stated, "But I think it is safe to say that Congress must in the future approach the questions of . . . organizational picketing among others. These have not settled to the satisfaction of anyone. At the present time, we probably do not have enough information to settle them to the satisfaction of anyone." *Id.* at 10374. The restriction upon recognition picketing having been rejected, S. 3974 then

passed the Senate (104 Daily Cong. Rec. 10381 (June 17, 1958)), but it failed of enactment when the House declined to suspend the rules to vote upon it (104 Daily Cong. Rec. 16817, 16841 (August 18, 1958)).[12]

It is thus evident that Congress remains now, as it was when it enacted Section 8(b)(4)(C) and as it has been in the interval, extremely tentative in coming to grips with the ramified problem of recognition picketing.[13] It is plain from the terms of Section 8(b)(4)(C), and from its history before and after its enactment, that Congress has been willing to commit itself only to the limited extent of prohibiting strikes and picketing by a union to compel its recognition when another union has been certified as the representative. Beyond this Congress as yet refuses to go. As Senator Johnston said, "I think it is safe to say that Congress must in the future approach the questions," but "At the present time we probably do not have enough information to settle them to the satisfaction of anyone." Nevertheless the Board interprets Section 8(b)(1)(A) to constitute a blanket prohibition of all picketing to secure the recognition of a union which does not represent a majority, and indeed it studiously refrains from holding that the prohibition does not also extend to organizational picketing (Bd. br. p. 28, n. 15, pp. 60-61). Thus Congress in its ignorance labors mightily to decide whether to enact into law a prohibition which according to the Board is already in effect. The truth of course is that the Board rushed in where Congress fears to tread. But it is Congress, not the Board, which is the lawmaker. Until Congress decides differently the law is that picketing for recognition is circumscribed only to the narrow extent defined by Section 8(b)(4)(C).

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[12] Aside from the measure described in the text, other bills pertaining to recognition picketing were introduced in the 85th Congress, and we set these out in the Appendix, *infra*, pp. 59-60.

[13] For an insight into how troubling the underlying policy considerations are pro and con, compare Cox, *Some Current Problems in Labor Law: An Appraisal*, 35 LRRM 48, 53-57, with Meltzer, *Recognition-Organizational Picketing and Right-to-Work Laws*, 9 Lab. L. Jour. 55.

B. Section 8(b)(1)(A), Unlike Section 8(b)(4)(C), Is Concerned With Means, Not End; Its Purpose Is to Assure That Unions Do Not Engage in Physical Force, or Threats of Force, or Economic Reprisal to Achieve Their Ends.

If Section 8(b)(4)(C) means what it says, then Section 8(b)(1)(A) cannot mean what the Board holds. The two indeed have separate functions which do not overlap. Section 8(b)(4) is concerned with the "end sought," with defining "proscribed objectives." *International Brotherhood of Electrical Workers* v. *N.L.R.B.*, 341 U.S. 694, 702; see also *id.* at 704. By Section 8(b)(1)(A), on the other hand, "Congress was aiming at means, not end." *Perry Norvell Co.*, 80 NLRB 225, 239. "By Section 8(b)(1)(A), Congress sought to fix the rules of the game, to insure that strikes and other organizational activities of employees were conducted peaceably by persuasion and propaganda and not by physical force, or threats of force, or of economic reprisal." *Ibid.* When the Board interprets Section 8(b)(1)(A) to prohibit peaceful picketing, because its purpose is to secure the recognition of a minority union, it transforms Section 8(b)(1)(A) from a provision designed to curb picketing, when conducted by coercive means, into an instrument to curb picketing, however peaceful, because of the end it furthers. This fundamentally alters the function of Section 8(b)(1)(A) within the statutory scheme.

The Board objects, however, that Section 8(b)(1)(A) prohibits restraint and coercion of employees *simpliciter;* that peaceful picketing, if successful, causes an employer to lose business; that this loss operates also as economic pressure upon the employees who earn their livelihood from that business; and that peaceful picketing is therefore a coercive technique squarely within the "ordinary meaning" of the words "restrain or coerce" (Bd. br. p. 18). The obvious vice in the argument is that it engulfs all peaceful picketing whatever its purpose. For this consequence of picketing ensues regardless of the end it serves. The question-begging character of the argument has been

recently lucidly exposed by the Arizona Supreme Court (*International Brotherhood of Carpenters, Local 857* v. *Storms Construction Co.*, 324 P.2d 1002, 1005, 42 LRRM 2116, 2119):

> We recognize that the obvious result of picketing is the refusal of other union employees to cross the picket line and thereby curtail the delivery of material and supplies to plaintiff's building project. The economic effect of picketing is a matter of general knowledge. But the effect is the same whether the peaceful picketing is for a lawful or an unlawful object. Hence, proof alone of the economic effect of picketing on the employer is not sufficient as a matter of law to establish an unlawful object or purpose which the state can prohibit.

Neither is it a sufficient basis for the Board to act.

Nor is there any escape from the patent impossibility of the Board's interpretation—one which outlaws all peaceful picketing—by looking to that part of Section 8(b)(1)(A) which confines its operation to restraint and coercion of employees "in the exercise of the rights guaranteed in Section 7." For Section 7 guarantees the right to engage in and "to refrain from *any or all of*" union activity. There is virtually no union activity to which some employees are not opposed. Upon the Board's analysis of the coercive consequence of peaceful picketing, any picketing in furtherance of any union activity will inescapably restrain and coerce some employees in the exercise of their right to refrain from it. *National Maritime Union,* 78 NLRB 971, 986, enforced, 175 F.2d 686 (C.A. 2), cert. denied, 338 U.S. 954; *Perry Norvell Co.,* 80 NLRB 223, 240.

The Board recognizes the dilemma of its position. It seeks to extricate itself by saying that it will strike "a balance between practices inimical to the organizational freedom of employees" and the need for "protection of legitimate competing interests" (Bd. br. p. 27), and it

will not curb picketing if the restraint it exerts is "justified as necessary to the protection of a competing interest which the Act recognizes . . ." (Bd. br. p. 30; see *passim* pp. 26-30, 58-61). Thus the Board, starting from the comfort of "a clear and literal violation of Section 8(b)(1)(A)" (Bd. br. p. 58), quickly abandons it, because its reading clearly and literally prohibits all picketing. To make its escape the Board would arrogate to itself the role of social arbiter of what it is good or bad to picket for. And the escape the Board thus makes identifies the precise vice of its interpretation. For the balance the Board would strike Congress has already struck for itself. Congress has in Section 8(b)(4)(C) defined the exact extent to which it means to go in curbing picketing for recognition purposes. It has left no penumbral area which the Board is free to explore for itself. Instead, both before and after the enactment of Section 8(b)(4)(C), Congress has shown itself fully alert to the complete range of the problem, and it has as a matter of deliberate choice declined as yet to go beyond the point fixed by Section 8(b)(4)(C). That choice may be good, bad, or indifferent, but it is for Congress to make. "It is not necessary for us to justify the policy of Congress. It is enough that we find it in the statute. That policy cannot be defeated by the Board's policy. . . . To sustain the Board's contention would be to permit the Board under the guise of administration to put limitations in the statute not placed there by Congress." *Colgate-Palmolive-Peet Co.* v. *N.L.R.B.,* 338 U.S. 355, 363.

The Board is in this abyss soley because of its latter-day misinterpretation of the reach of Section 8(b)(1)(A). By reading that section as if it were concerned with ends, not means, the Board has now done what the opponents of Section 8(b)(1)(A) feared could be its consequence but what its proponents assured would not. Section 8(b)(1)(A) originated in the Senate and had no counterpart in that form in the House. After the Senate Labor Committee

by a closely divided vote rejected its inclusion in the bill it would report,[14] a minority stated it would offer on the Senate floor an amendment making it an unfair labor practice for a union "to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7."[15] The thought behind the amendment was the "many instances of union coercion of employees such as that brought about by *threats of reprisal* against employees and their families in the course of organizing campaigns; also direct interference by *mass picketing and other violence.* * * * We believe that the freedom of the individual workman should be protected from duress by the union as well as duress by the employer"[16] (Emphasis supplied.)

The amendment was thereafter offered on the Senate floor by Senator Ball.[17] It met with much opposition.[18] To placate that opposition the words "interfere with" were expunged from the amendment by unanimous consent.[19] This was done to allay fear that, in derogation of "union organizational activities," the amendment could "be construed to mean that any conversation, any persuasion, any urging upon the part of any person to persuade another to join a labor organization, would constitute an unfair labor practice."[20]

Even as so restricted, it was charged that the amendment "would slow up the organizational activity of unions,"[21] that "it will have the effect of outlawing organi-

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14 S. Rep. No. 105, 80th Cong., 1st Sess., 50, in 1 Leg. Hist. 456; 93 Cong. Rec. 4435, in 2 Leg. Hist. 1204.

15 *Ibid.*

16 *Ibid.*

17 93 Cong. Rec. 4016, in 2 Leg. Hist. 1018.

18 93 Cong. Rec. 4016-4025, in 2 Leg. Hist. 1018-1033.

19 93 Cong. Rec. 4271, in 2 Leg. Hist. 1138-1139.

20 *Ibid.*

21 93 Cong. Rec. 4430, in 2 Leg. Hist. 1195.

zational strikes and strikes for recognition."[22] In answer to this charge a colloquy ensued between Senators Taft and Saltonstall which has every earmark of being the definitive summing up by its proponents of the reach of Section 8(b)(1)(A). Senator Saltonstall initiated the colloquy: "I would appreciate very much, in order to make the matter clear in my own mind, if . . . Senator [Taft] . . . would give an example of a restraint he would consider an unfair labor practice, an action which would not be a restraint, an action which would be coercion, and an action which would not be coercion, within the meaning of the words of the bill and the amendment."[23] Senator Taft began by stating his understanding of the reach of the existing section against employers:[24]

> . . . I understand the present section against employers has been used by the Board to prevent employers from making threats to employees to prevent them or dissuade them from joining a labor union. They may be threats to fire the man, of course, in the extreme case. They may be threats to reduce his wages, they may be threats to visit some kind of punishment on him within the plant if he undertakes to join a union. Those are the usual types of coercion which have been held to be a violation of the section on the part of the employers. In the case of employers, there have also been some cases of threats of violence. . . .

Senator Taft then explained the reach of the amendment against unions:[25]

> In the case of unions, in the first place, there might be a threat that if a man did not join, the union would raise the initiation fee to $300, and he would have to pay $300 to get in; or there might be a threat that if he did not join, the union would get a closed-shop

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[22] 93 Cong. Rec. 4431, in 2 Leg. Hist. 1197.

[23] 93 Cong. Rec. 4435, in 2 Leg. Hist. 1205.

[24] *Ibid.*

[25] 93 Cong. Rec. 4435-4436, in 2 Leg. Hist. 1205.

agreement and keep him from working at all. Then, there might be a threat of beating up his family or himself if he did not join and sign a card. I think, when we get to the case of unions, there might be the actually violent act of forcibly, by mass picketing, preventing a man from working.

Let us take the case of mass picketing, which absolutely prevents all the office force from going into the office of a plant. That would be a restraint and coercion against those employees, an interference with their right to work.

Senator Taft then summed up:[26]

The effect of the pending amendment is that the Board may call the union before them, exactly as it has called the employer, and say, "Here are the rules of the game. You must cease and desist from coercing and restraining the employees who want to work from going to work and earning the money which they are entitled to earn." The Board may say, "*You can persuade them; you can put up signs; you can conduct any form of propaganda you want to in order to persuade them,* but you cannot, by threat of force or threat of economic reprisal, prevent them from exercising their right to work." As I see it, that is the effect of the amendment. (Emphasis supplied.)

* * *

[The amendment] will slow up organizational drives only if they are accompanied by threats and coercion. The cease-and-desist order will be directed against the use of threats and coercion. *It will not be directed against the use of propaganda or the use of persuasion, or against the use of any of the other peaceful methods of organizing employees.* (Emphasis supplied.)

* * * It would outlaw threats against employees. It would not outlaw anybody striking who wanted to strike. It would not prevent anyone using the strike in a legitimate way, *conducting peaceful picketing, or employing persuasion.* (Emphasis supplied.)

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[26] 93 Cong. Rec. 4436, in 2 Leg. Hist. 1206, 1207.

In a later analysis, Senator Taft explained that the prohibitions of Section 8(b)(1)(A) "apply to *coercive acts* of unions against employees who do not wish to join or did not care to participate in a strike or a picket line";[27] and the "coercive conduct" against which the employee is protected is "physical and economic coercion. For example, in the absence of a valid compulsory union-membership contract if a union compelled a man to join it or to sign an application card by threatening him with loss of his job, this would be economic coercion. Both threats of violence and threats of this kind are prohibited. * * * [I]t will cover intimidating conduct or physical force used . . . [in] picketing. . . ."[28]

What clearly emerges from the debate is absolute affirmation that peaceful picketing is not comprehended within the concept of restraint and coercion. There is unequivocal assurance that "you can put up signs;" that none of the "peaceful methods of organizing employees" is affected; that no one would be prevented from "conducting peaceful picketing."[29] Indeed, the kind of picketing which does fall within the scope of Section 8(b)(1)(A)—mass or violent—denotes precisely the picketing which does not—peaceful. And on the face of Section 8(b)(1)(A) it would be an extraordinary interpretation of its words to find, as in this case, that it constituted restraint or coercion for a single picket to walk quietly up and down in front of an employer's premises carrying a sign.

Nor is there any substantial showing that it was thought that within the meaning of Section 8(b)(1)(A) peaceful picketing acquires the character of restraint or coercion because of the purpose it furthers. To be sure, the Board musters a few examples from an early stage of the debate

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[27] 93 Cong. Rec. 6859, in 2 Leg. Hist. 1623 (emphasis supplied).

[28] 93 Cong. Rec. A3369.

[29] In 1949 Senator Taft, together with Senators Smith and Donnell, labelled as "of course . . . untrue" the charge that Section 8(b)(1)(A) "forbids 'peaceful' picketing." S. Rep. No. 99, Pt. 2, 81st Coug., 1st Sess., 24.

which may tend to suggest this (Bd. br. pp. 24-26, 65-67). But each of these examples was tendered *prior* to the deletion of the words "interfere with" from Section 8(b)(1)(A). It may be that, viewed nakedly, the deletion is not substantial, but its true significance lies in its reflection of a marked change in mood.[30] For the earlier expansiveness in describing Section 8(b)(1)(A) was never again suggested after this change. For example, before the change, Senator Ball was strident in his claim that Section 8(b)(1)(A) would reach "false promises or false statements" by unions;[31] after the change, Senator Ball agreed that Section 8(b)(1)(A) does not reach "misrepresentation."[32] And, after the change, Senator Taft's authoritative explanation of Section 8(b)(1)(A) did not even intimate that peaceful picketing would come within its purview by virtue of its purpose. It is fair to say that, whatever ambitions its proponents may have had for Section 8(b)(1)(A) at the beginning, they quickly squelched them in favor of a more modest role, lest they fail to have any acceptance of it at all.

Nor is the Board's position helped by the much stressed circumstance that the Section 8(b)(1)(A) restriction upon unions parallels the Section 8(a)(1) restriction upon employers. Both employers and unions are subjected to a duty to the employees, and in that meaningful sense equality is established between them. But the duty may be different precisely because unions and employers are different in character, function, and history. "The same words, in different settings, may not mean the same thing."[33] Even before the deletion of the words "interfere with," Senator Taft recognized that interference, restraint, and coercion in application to labor organizations

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[30] *Cf. Universal Camera Corp.* v. *N.L.R.B.*, 340 U.S. 474, 487.

[31] 93 Cong. Rec. 4016, 4017, in 2 Leg. Hist. 1018-1019, 1020.

[32] 93 Cong. Rec. 4434, in 2 Leg. Hist. 1202.

[33] *Skelly Oil Co.* v. *Phillips Petroleum Co.*, 339 U.S. 667, 678.

may have a "different implication. . . ."[34] And so, "Because Section 8(b)(1) was designed as the co-part of Section 8(a)(1), it does not follow that each and every rule established by the Board in cases involving employer interference, restraint, and coercion must mechanically be transposed to cases involving union restraint and coercion, with every 'i' dotted and every 't' crossed and without regard to whether or not the controlling principles are the same."[35] It is thus not "very significant that Section 8(b)(1) follows the familiar phraseology of Section 8(a)(1), although it omits the word 'interfere', or that its sponsors repeatedly explained that the new section would make it unfair for labor organizations to engage in activities which were unfair when engaged in by employers. While the Board's decisions under the older section may give some slight help in interpreting the new provision, it is clear that there are important differences." Cox, *Some Aspects of the Labor Management Relations Act, 1947,* 61 Harv. L. Rev. 1, 30-31 (1947).[36]

The upshot is that the insubstantial fragments upon which the Board relies cannot reasonably support the extravagant meaning it imputes to Section 8(b)(1)(A).[37]

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[34] 93 Cong. Rec. 4023, in 2 Leg. Hist. 1028.

[35] *International Typographical Union,* 86 NLRB 951, 1021, affirmed on this point, 193 F. 2d 782, 801, 806 (C.A. 7), cert. denied, 344 U.S. 812.

[36] The writer goes on to say: "For example, although an employer is forbidden to express the hope that he may be able to raise wages and improve working conditions if the union is defeated, the counter-argument made by labor organizations to secure union members—that if enough employees join the union it will be able to obtain additional advantages—is clearly legitimate. Nor would it seem to be improper for a union to promise economic advantages only to those who become members. Many unions offer mutual insurance, vacations, and similar benefits to members, in addition to what is obtained by collective bargaining, which surely they must be free to point out in seeking members. Much the same distinction is true of social pressures. While an employer may not segregate a union employee in order to hold him up to the ridicule of his fellows, it will scarcely be asserted that labor organizations are forbidden to ostracize nonmembers or to impose other social pressures upon them."

[37] The Board also contends that Section 9(c)(3) of the Act supports its interpretation of Section 8(b)(1)(A), the argument being that, as Section 9(c)(3) prohibits the Board's direction of a second election within one year of the Board's conduct of a valid election within the bargaining unit, the

Picketing is within 8(b)(1)(A) only to the extent of curbing its conduct by coercive means; if picketing is peaceful, 8(b)(1)(A) is indifferent to the end it serves. The implications of Section 8(b)(4)(C) are too plain, the restricted role of Section 8(b)(1)(A) too clear, for any other reading. The indirection which it is necessary to assume in order to reach the Board's result is "so far-fetched and forced as to bring into question the candor of Congress as well as the integrity of the interpretative process." [38] "Such an innovation is so radical and important that it would have been introduced explicitly, if intended. . . ." [39] If more were needed to show this, final confirmation is found in the material to which we now turn.

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policy of Section 9(c)(3) is subverted if a union may strike or picket for recognition during a period that the Board's election machinery is unavailable (Bd. br. p. 28, n. 14, p. 70). The argument proves too much. If it were valid, it would prohibit a recognition strike or picketing by a majority no less than a minority within one year of a previous election, for in either event the Board may not conduct an election during that time. No one suggests that this can possibly be true. *Ecko Products Co.*, 117 NLRB 137, 142-144. Furthermore, it is settled that the Board's election machinery exists as an alternative to, not in lieu of, self-help to secure recognition. *United Mine Workers* v. *Arkansas Oak Flooring Co.*, 351 U.S. 62. Nothing in Section 9(c)(3) is designed to affect this fundamental premise. Its role is considerably more modest. Its purpose is to bring about a single change in the Board's pre-1947 electoral practice. Before 1947 the Board would entertain a petition of a defeated union for a second election within a year of the union's loss of a preceding election in substantially the same unit if it made "a showing of renewed and extended organizational efforts." *Borden Company,* 69 NLRB 947, 948, and cases cited at notes 4 and 7. See also, *J. C. Blair Co.*, 74 NLRB 408, 409. Critical of this practice (S. Rep. No. 105, 80th Cong., 1st Sess., 25, in 1 Leg. Hist 431), Congress enacted a blanket prohibition against the Board's conduct of a second election within a year of the first regardless of the petitioning union's new and improved showing of support obtained after the first election. The terms of Section 9(c)(3) do not express, and its purpose does not go beyond, any objective other than this narrow procedural limitation upon access to the Board's election machinery. Indeed, as the report of the Joint Committee states, the very fact that the Board's electoral processes are unavailable for a year after an election is itself a reason in favor of not prohibiting recognition strikes and picketing during that time, there being no other means by which the employees can compel recognition (*supra,* p. 13). Finally, the 85th Congress has just rejected a proposal to prohibit recognition strikes and picketing "where within the preceding 12 months a valid election under section 9(c) of this Act has been conducted" (*supra,* p. 16). The Board continues to attempt to outrun Congress.

[38] *Western Union Tel. Co.* v. *Lenroot*, 323 U.S. 490, 508.

[39] Cox, *op. cit. supra,* p. 27, at 28.

C. The Board's Construction of Section 8(b)(1)(A) Conflicts With Sections 8(c) and 13; It Reverses a Long-Standing Interpretation; and It Renders Section 8(b)(4)(C) Redundant.

1. *Section 8(c)*

When fear was expressed that Section 8(b)(1)(A) was capable of expansive interpretation, Senator Taft stated that Section 8(c) would guard against it, observing that "the provision regarding free speech applies both to employer and employee."[40] Section 8(c) provides that:

> The expressing of any views, argument, or opinion or the dissemination thereof, whether in written, printed, graphic, or visual form, shall not constitute or be evidence of an unfair labor practice under any of the provisions of this Act, if such expression contains no threat of reprisal or force or promise of benefit.

Peaceful picketing is plainly the "expressing" and "dissemination" of "views, argument, or opinion" "in written, printed, graphic, or visual form." "Peaceful picketing is the workingman's means of communication" (*Milk Wagon Drivers Union* v. *Meadowmoor Dairies, Inc.*, 312 U.S. 287, 293); it is therefore "in part an exercise of the right of free speech guaranteed by the Federal Constitution" (*Building Service Union* v. *Gazzam*, 339 U.S. 532, 536-537). And unless it contains a "threat of reprisal or force or promise of benefit"—which *peaceful* picketing does not—Section 8(c) states that speech "shall not constitute or be evidence of an unfair labor practice under any of the provisions of this Act. . . ." Section 8(b)(1)(A)—one "of the provisions of this Act"—cannot therefore be held to embrace peaceful picketing.

The Board contends that *Electrical Workers* v. *N.L.R.B.*, 341 U.S. 694, "is conclusive" that Section 8(c) of the Act is "inapplicable to this case" (Bd. br. p. 39). Precisely the contrary is true. That case holds only that the "gen-

[40] 93 Cong. Rec. 4020, in 2 Leg. Hist. 1023.

eral terms of § 8(c) appropriately give way to the specific provisions of § 8(b)(4)" (341 U.S. at 705-706). This conclusion was reached upon consideration of the specific words of Section 8(b)(4)—making it an unfair labor practice "to *induce or encourage* the employees of any employer"—the place of Section 8(b)(4) in the statutory scheme, and the purpose it was designed to serve. And in reaching this conclusion the Supreme Court *contrasted* the breadth of Section 8(b)(4) with the restricted reach of Section 8(b)(1)(A).

Thus, the Supreme Court stated that "The intended breadth of the words 'induce or encourage' is emphasized by their contrast with the restricted phrases used in other parts of § 8(b). For example, the unfair labor practice described in § 8(b)(1) is one 'to restrain or coerce' employees. . ." (341 U.S. at 703). In addition, the Supreme Court observed that to read Section 8(c) into Section 8(b)(4) would *duplicate* the reach of Section 8(b)(1)(A), for it would then limit the type of inducement reached by Section 8(b)(4) to that containing a "threat of reprisal or force or promise of benefit," the very limitation written into Section 8(b)(1)(A). Said the Court (341 U.S. at 701-702):

> To exempt peaceful picketing from the condemnation of §8(b)(4)(A) as a means of bringing about a secondary boycott is contrary to the language and purpose of that section. The words "induce or encourage" are broad enough to include in them every form of influence and persuasion. There is no legislative history to justify an interpretation that Congress by those terms has limited its proscription of secondary boycotting to cases where the means of inducement or encouragement amount to a "threat of reprisal or force or promise of benefit." Such an interpretation would give more significance to the means used than to the end sought. If such were the case there would have been little need for § 8(b)(4) defining the proscribed objectives, because the use of "restraint and coercion"

for any purpose was prohibited in this whole field by §8(b)(1)(A).

Thus the Supreme Court stated in so many words that Section 8(b)(1)(A) does not reach peaceful picketing; that to give Section 8(b)(4) meaningful scope it was necessary to read it to go beyond Section 8(b)(1)(A) so as to reach peaceful picketing; and that the difference between Section 8(b)(4) and Section 8(b)(1)(A) was that in Section 8(b)(4) Congress intended to reach picketing because of its purpose. As the Supreme Court later highlightingly stated, quoting the Board, Congress was in Section 8(b)(4) concerned with "the *objective* . . . and not the *quality of the means* employed to accomplish that objective . . ." (341 U.S. at 704). The Court thus explicitly approved (341 U.S. at 702, n. 6, 703-704) the Board's approach articulated in *United Brotherhood of Carpenters,* 81 NLRB 802, 813, enforced, 184 F. 2d 60, 62 (C.A. 10), cert. denied, 341 U.S. 947:

> The lack of logic in importing Section 8(c) into Section 8(b)(4)(A) so as, in effect, to redefine inducement and encouragement of employees in terms of restraint and coercion is further cogently demonstrated by the fact that by so doing Section 8(b)(4)(A) in that respect would duplicate and reach the same conduct as Section 8(b)(1)(A), which makes it an unfair labor practice "to restrain or coerce" employees, except that Section 8(b)(4)(A) would require additional proof of object. As the Board has recently pointed out in the *Perry Norvell* case [80 NLRB 225, 239] "The legislative history [Section 8(b)(1)(A)] of the Act shows that, by this particular section, Congress primarily intended to proscribe the coercive conduct which sometimes accompanies a strike. . . By Section 8(b)(1)(A) Congress sought . . . to insure that strikes and other organizational activities of employees were conducted peaceably by persuasion and propaganda and not by physical force, or threats of force or of economic reprisal. In that Section, Congress was aiming at *means, not ends.*" In these circumstances,

> we are unable to believe that Congress intended to do such a meaningless thing as to make conduct, which it had already prohibited in an earlier section in the statute (8(b)(1)(A)), an unfair labor practice in a later section (8(b)(4)(A)) conditioned, however, on further proof of unlawful objective. In the final analysis, it is plain from the different purposes these provisions were intended to serve in the statutory scheme that Congress contemplated that a broader scope be given to the phrase "induce or encourage" in Section 8(b)(4)(A) than to the phrase "restrain or coerce" in Section 8(b)(1)(A). By reading Section 8(c) into Section 8(b)(4)(A) this intention of Congress would be defeated.

Thus the Supreme Court's decision in *Electrical Workers* confirms the exemption of peaceful picketing from the reach of Section 8(b)(1)(A) and the applicability of Section 8(c) to quarantee its immunity.[41]

2. *Section 13.*

The Board's current interpretation of Section 8(b)(1)(A), in addition to conflicting with Section 8(c), is also at odds with Section 13. That section provides:

> Nothing in this Act, except as specifically provided for herein, shall be construed so as either to interfere

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[41] *International Brotherhood of Teamsters* v. *Vogt,* 354 U.S. 284, and the cases it summarizes, do not detract from this view. The doctrine of these cases is relevant only to the power of Congress *constitutionally* to prohibit picketing for the purpose of securing the immediate recognition of a minority union. We do not doubt the power of Congress, but the question here is whether Congress has exercised the power, not whether it could. *Vogt* is not relevant to this question of statutory interpretation. That picketing is more than speech does not mean that it is not speech at all. As speech it is within Section 8(c). It is noteworthy that Section 8(c) was enacted in 1947. The Supreme Court's emphasis of the non-speech aspects of picketing began no earlier than 1949 with *Giboney* v. *Empire Storage & Ice Co.*, 336 U.S. 490, and probably not until 1950 with *Hughes* v. *Superior Court*, 339 U.S. 460, and related cases (*International Brotherhood of Teamsters* v. *Hanke,* 339 U.S. 470; *Building Service Employers* v. *Gazzam,* 339 U.S. 532). The great likelihood is that Section 8(c) reflected the earlier emphasis upon the speech aspects of peaceful picketing. In any event, recognition of the non-speech aspects of picketing has not effaced its speech attributes, as the Supreme Court made clear in 1958 in *Chauffeurs, Teamsters & Helpers Local Union No. 795* v. *Newell,* 356 U.S. 341, in reaffirming *Thornhill* v. *Alabama,* 310 U.S. 88, 98, *Third.*

with or impede or diminish in any way the right to strike, or to affect the limitations or qualifications on that right.

As explained by the Supreme Court, "By § 13, Congress has made it clear that * * * all * * * parts of the Act which otherwise might be read so as to interfere with, impede or diminish the union's traditional right to strike, may be so read only if such interference, impediment, or diminution is 'specifically provided for' in the Act." *N.L.R.B.* v. *International Rice Milling Co.,* 341 U.S. 665, 673. There is nothing in Section 8(b)(1)(A) which "specifically" provides for the impairment of the right to strike and picket which the Board would effect. See *Mastro Plastics Corp.* v. *N.L.R.B.,* 350 U.S. 270, 284.

It is no answer to say, as the Board would (Bd. br. p. 61), that Section 13 applies to strikes, not picketing. If peaceful picketing constitutes restraint and coercion, obviously an actual strike *a fortiori* does, and it would be artful in the extreme to suggest that the Board's current holding does not condemn both when engaged in to secure the recognition of a minority union. Furthermore, little indeed would be left of the right to strike if the right to picket were not protected as an inseparable part of it (*Schultz Refrigerated Service, Inc.,* 87 NLRB 502, 504-505), and for that reason section 13 cloaks both (*Sales Drivers Union* v. *N.L.R.B.,* 229 F.2d 514, 517-518, cert. denied, 351 U.S. 972). Finally, by the very latitude of its language, Section 8(b)(1)(A) is precisely the sort of provision for which the tethering effect of Section 13 was designed.

3. *The Board's reversal of a long-standing interpretation.*

In 1948, after full consideration, the Board decided that the touchstone of illegality under Section 8(b)(1)(A) is, not the purpose to accomplish an "illegal objective," but

"the *means* by which it is accomplished. . . ." *National Maritime Union,* 78 NLRB 971, 986, enforced, 175 F.2d 686 (C.A. 2), cert. denied, 338 U.S. 954. And so the Board dismissed a complaint insofar as it alleged that, by a strike, picketing, and a wrongful refusal to bargain to secure an invalid hiring hall, the union violated Section 8(b)(1)(A) (*id.* at 982-987).[42] The same year the Board decided *Perry Norvell Co.,* 80 NLRB 224, in which, again after full consideration, the Board held that in Section 8(b)(1)(A) "Congress was aiming at means, not end" (*id.* at 239). It therefore dismissed a complaint insofar as it alleged that the union violated Section 8(b)(1)(A) by *inter alia* striking to compel the recognition of a minority union (*id.* at 238-241).[43] Until its abandonment in this and

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[42] The conduct was of course illegal under Sections 8(b)(2) and 8(b)(3) of the Act

[43] The Board would distinguish *Perry Norvell* upon the ground that it "did not involve picketing for exclusive recognition by a union that clearly did not represent a majority of the employees" (Bd. br. p. 71). As Member Murdock noted in his dissent in the *Curtis* case (Bd. br. p. 96, n. 46), "The Trial Examiner in this case [Curtis] points out, however, that the briefs in the *Perry Norvell* case and the Board's Fourteenth Annual Report, page 83, make clear that the strike in that case was by a minority group." The Trial Examiner in *Curtis* stated that (examiner's report, sl. op. p. 11):

> While the Board in the *Perry Norvell* decision did not explicate in so many words that the strike was one for recognition by a minority, it is noted that the briefs to the Board submitted by the General Counsel and counsel for Perry Norvell Company brought this fact to the Board's notice (General Counsel's brief, pp. 31, 32; Company's brief, pp. 62, 95). Indeed, the Board in its Fourteenth Annual Report submitted to Congress and to the President as provided in Section 3(c) of the Act, reporting among other things, the decisions it rendered, had the following to say (p. 83) regarding its *Perry Norvell* decision:
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> The Board also found no merit in the contention that a strike of a dissident group in violation of a no-strike clause,[23] and *non-violent attempts by a minority to unseat an incumbent union*[24] *constituted violations of Section 8(b)(1)(A).* [Emphasis supplied.]
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> [23] *Matter of Perry Norvell Company, supra.*
>
> [24] *Ibid.*

The report of the Joint Committee on Labor Management Relations had equally no difficulty in recognizing the import of *Perry Norvell* (Com. Print., Report No. 986, Part 3, 80th Cong., 2nd Sess., 85):

> Another instance of a strike to force an employer to violate the law is a strike by a minority group of employees for recognition. It seeks to deprive employees of their rights under Section 7 of the Act. . . . If an

the companion *Curtis* case, the Board followed this interpretation without deviation.[44]

Thus late in 1957 the Board overturns an interpretation adopted in 1948, within a year of the effective date of the Taft-Hartley amendments in 1947, and undeviatingly adhered to for nine years. Applicable here is the Supreme Court's condemnation of the attempt of the Interstate Commerce Commission to displace an administrative application of the Interstate Commerce Act apparently less than ten years old. Said the Supreme Court, "It would be diffi-

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employer accedes to such demand, he participates in forcing his employees to bargain collectively through an agent to which a majority of them are opposed. That such a strike is not an unfair labor practice under the present act has been made clear. In *Matter of Perry Norvell*, (80 NLRB No. , 23 LRRM 1061, Nov. 12, 1948) the Board held that a *strike by a minority group for recognition, where another union was recognized agent, did not constitute "restraint or coercion" of the employees in violation of Section 8(b)(1)(A)*. In other words, the Board held that the strike did not restrain or coerce the employees in the exercise of their right to choose their own bargaining representative or to refrain from choosing one, although its object was to force them to choose an agent to which a majority of them were opposed. (Emphasis supplied.)

Finally, if there is any doubt as to the meaning of *Perry Norvell* on its face, there is none as to *Local 74, United Brotherhood of Carpenters*, 80 NLRB 533, enforced, 181 F. 2d 126 (C.A. 6), affirmed, 341 U.S. 707. *Local 74* was decided 12 days after *Perry Norvell*. In Local *74*, as the Supreme Court observed, the union picketed Watson's store, for the purpose of inducing Watson "to enter into a closed-shop agreement with the union recognizing it as the bargaining agent," although none of Watson's employees were members of the union. 341 U.S. 707, 709. The Board dismissed the complaint insofar as it alleged a violation of Section 8(b)(1)(A) by the conduct of the union in *inter alia* "peacefully picketing Watson's own store at a time when Local 74 represented none of its employees. . . ." 80 NLRB at 539. (The case reached the Supreme Court upon findings that by other conduct the union violated Section 8(b)(4)(A) of the Act.)

[44] Strikes and picketing to secure the recognition of a minority union: *Local 74, United Brotherhood of Carpenters*, 80 NLRB 533, 539, 546-549, enforced, 181 F. 2d 126 (C.A. 6), affirmed, 341 U.S. 707; *District 50, United Mine Workers*, 106 NLRB 903, 909.

Strikes, picketing, and other action to secure invalid hiring hall, union shop, or closed shop conditions: *International Typographical Union*, 86 NLRB 951, 957-959 and cases cited at 956, n. 15, specifically affirmed as to this point, 193 F. 2d 782, 801, 806 (C.A. 7), cert. denied, 344 U.S. 812; *United Mine Workers*, 83 NLRB 916, 917, n. 3, 937-938; *National Maritime Union*, 82 NLRB 1365, 1366; *American Radio Ass'n.*, 82 NLRB 1344, 1345.

Strikes, picketing, and other action to secure other objectives: *Painters' District Council No. 6*, 97 NLRB 654, 655, 666-668 (to cause withdrawal of decertification petition); *Miami Copper Co.*, 92 NLRB 322, 323-324, 340-341 (to cause employer to treat with minority union in adjusting grievances contrary to employees' right to treat through majority representative.)

The foregoing list does not purport to be exhaustive.

cult indeed to conceive a clearer case of uniform administrative construction. . .''; ''all doubt is removed by the application of the rule that settled administrative construction is entitled to great weight and should not be overturned except for cogent reasons''; ''At this late date the courts ought not to uphold an application of the law contradictory of this settled administrative interpretation.'' *United States* v. *Chi. N. S. & Mil. R. Co.,* 288 U.S. 1, 13-14. See also, *Walling* v. *Halliburton Oil Well Cementing Co.,* 331 U.S. 17, 25-26; *United States* v. *South Buffalo Ry. Co.,* 333 U.S. 771, 774-775; *United States* v. *Ryan,* 284 U.S. 167, 174-175. This is peculiarly true here where the overturned interpretation involves a ''contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new.'' *United States* v. *American Trucking Assn's.,* 310 U.S. 534, 549, quoting from *Norwegian Nitrogen Co.* v. *United States,* 288 U.S. 294, 315.

4. *The redundancy of Section 8(b)(4)(C) on the Board's current interpretation of Section 8(b)(1)(A).*

Section 8(b)(4)(C) of the Act ''has no place in this Statute if Section 8(b)(1)(A) can be interpreted broadly to forbid picketing by a minority labor organization for recognition. For the type of picketing prohibited by Congress in Section 8(b)(4)(C) necessarily is in the category now forbidden under Section 8(b)(1)(A). Thus, through administrative interpretation of one provision, the specific language of another statutory provision in this Act has been reduced to a useless gesture.'' [45] We are therefore

[45] Member Fanning dissenting in *Paint, Varnish & Lacquer Makers Union, Local 1232,* 120 NLRB No. 89, sl. op. p. 10, 42 LRRM 1195, 1197. Upon the expiration of the term of Member Murdock, who dissented in this and the companion *Curtis* case, Member Fanning was appointed to succeed him. Not having participated in the earlier *Curtis* decision, Member Fanning considered his position on this issue *de novo,* and concluded that the Board's current interpretation of Section 8(b)(1)(A) was an impermissible construction.

required to conclude, if we are to accept the Board's current interpretation of Section 8(b)(1)(A), that Section 8(b)(4)(C) is an idle collection of words. That conclusion is impermissible. "We are not at liberty to construe any statute so as to deny effect to any part of its language. It is a cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word. As early as in Bacon's Abridgment, section 2, it was said that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' This rule has been repeated innumerable times. Another rule equally recognized, is, that every part of a statute must be construed in connection with the whole, so as to make all parts harmonize, if possible, and give meaning to each." *Washington Market Co.* v. *Hoffman,* 101 U.S. 112, 115-116.

To escape the force of this observation the Board brief makes three meritless arguments. We turn to these.

(a) The Board brief argues that Section 8(b)(4)(C) prohibits a *majority* union from striking or picketing for recognition, even if the incumbent union has only minority support, so long as the incumbent's certification as the representative remains formally unrevoked; whereas Section 8(b)(1)(A) prohibits only minority strikes or picketing for recognition (Bd. br. pp. 32-33). But the view that Section 8(b)(4)C) prohibits majority strikes or picketing for recognition in the face of an unrescinded certification of a minority union commands the assent of only two of the five members of the Board;[46] the Board itself has explicitly reserved decision upon this question;[47] and the

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[46] *Paint, Varnish & Lacquer Makers Union, Local 1232,* 120 NLRB No. 89, sl. op. p. 4, n. 5, 42 LRRM 1195, 1196, n. 5.

[47] *District 50, United Mine Workers,* 106 NLRB 903, 906. See also, *Warehouse & Distribution Workers Union, Local 688,* 116 NLRB 923, 924; *Local No. 224, Allied Industrial Workers,* 116 NLRB 890, 892.

question is an unsetlled and extremely troubling one.[48] Moreover, even if we accept the proposition stated in the Board brief, it hardly follows that this constitutes an adequate explanation of Section 8(b)(4)(C)'s reason for being. For, during the first year of its certification, a certified union is ordinarily conclusively deemed to possess majority status (*Ray Brooks* v. *N.L.R.B.*, 348 U.S. 96), and thereafter it is presumptively deemed to possess majority status (*Celanese Corporation,* 95 NLRB 664, 672). It turns things upside down to find the true importance of Section 8(b)(4)(C), not in the protection it extends to the conclusive or presumptive majority status of the certified union, but in the supposed solicitude for the status of a minority union whose certification is formally unrevoked. "This suggested residue of utility left to 8(b)(4)(C) is . . . of little significance." [49]

(b) The second argument in the Board brief is this: for violations of Section 8(b)(4)(C), the temporary injunction procedures of Section 10(1) are applicable, whereas for violations of Section 8(b)(1)(A) those of Section 10(j) apply; that for violations within the purview of Section 10(l) the Board *must* seek a temporary injunction, while for those within 10(j) the Board *may* seek a temporary injunction; and that Congress differentiated between recognition strikes and picketing, placing those where another union was certified under Section 8(b)(4)(C) and others under Section 8(b)(1)(A), in order to make the 8(b)(4)(C) violation "subject to the mandatory injunction feature" (Bd. br. p. 34).

This is a truly extraordinary explanation. Tying it in with the first explanation in the Board brief, it means that

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[48] The view expressed in the Board brief is in conflict with *Kennedy* v. *Warehouse Workers Union, Local 688*, 37 LRRM 2496, 2499 (D.C.E.D. Mo.). Of the four cases cited in the Board's brief at p. 33, n. 19, we read only *Parks* v. *Atlanta Printing Pressmen*, 243 F. 2d 284 (C.A. 5), cert. denied, 354 U.S. 937, as square support for the position stated in the Board brief.

[49] Member Fanning dissenting in *Paint, Varnish & Lacquer Makers Union, Local 1232*, 120 NLRB No. 89, sl. op. p. 11, 42 LRRM 1195, 1198.

Congress intended it to be *mandatory* for the Board to seek a temporary injunction restraining *majority* strikes and picketing for recognition, if the incumbent was a minority union still possessing an unrevoked certification, but that Congress left it *discretionary* with the Board to seek a temporary injunction restaining *minority* strikes and picketing where no certified union was in the picture! The truth is that the separate temporary injunction procedures have nothing to do with defining the scope of the substantive wrong. As the Board explained in *Perry Norvell Co.*, 80 NLRB 225, 240:

> The General Counsel, to be sure, asserts that a strike for recognition in the face of an outstanding certification of another labor organization is an unfair labor practice also under Section 8(b)(1)(A), as well as under Section 8(b)(4)(C), and that the latter section is not thereby rendered redundant. He argues that its purpose is merely to insure the expeditious handling of, and the immediate application for appropriate injunctive relief against, recognition strikes in the face of an outstanding certification. However, Section 8 does not deal with remedy. It is devoted solely to defining unfair labor practices by employers and labor organizations. It is Section 10(1) that deals with special remedies in strike situations under Section 8(b)(4)(C). If Congress had really intended Section 8(b)(4)(C) to have primarily a procedural effect, it would surely have inserted its terms in Section 10, rather than in Section 8.

Indeed, it is plain on the face of Section 10(l) that when Congress truly sought a differentiation in remedy, it said so in the remedy section, not by indirection in the substantive section. Section 8(b)(4) defines four substantive violations, (A), (B), (C), and (D). With respect to the first three, Section 10(l) specifies the procedure to be followed "Whenever it is charged that any person has engaged in an unfair labor practice within the meaning of paragraph 4(A), (B), or (C) of section 8(b)," including

a mandatory application for a temporary injunction if there is reasonable cause to believe that a violation has been committed. The concluding sentence of Section 10(l) then reads: "In situations where such relief is appropriate the procedure specified herein shall apply to charges with respect to section 8(b)(4)(D)." Thus, when Congress sought to make an application for a temporary injunction discretionary where, unlike subdivisions (A), (B), or (C), a subdivision (D) violation was charged, it expressed its purpose in the remedy section. It did not remove subdivision (D) from its position in Section 8(b)(4) and place it elsewhere in section 8(b). Neither did it insert subdivision (C) into Section 8(b)(4) in order to achieve a procedural end.

(c) Another argument in the Board brief is that, "in particularizing in some of the later subsections of 8(b) conduct that is also covered by the more general language of 8(b)(1)(A), Congress was only following the established pattern of draftsmanship employed in Section 8(a), where subsequent subsections deal with specific forms of employer restraint and coercion prohibited in Section 8(a)(1)." (Bd. br. pp. 33-34.) This is the sort of uncritical paralleling of Section 8(a)(1) and Section 8(b)(1)(A) which we have already discussed (*supra*, pp. 26-27). As the Court of Appeals for the Seventh Circuit held, "Nor can we agree with the contention . . . that a violation of other subsections of 8(b) are also necessarily violations of § 8(b)(1)(A) in the same manner that violations of other subsections of § 8(a) have been held to be violations of § 8(a)(1)." *American Newspaper Publishers Ass'n.* v. *N.L.R.B.*, 193 F.2d 782, 801, cert. denied, 344 U.S. 812. For, "it is clear from the wording of § 8(b)(1)(A) that it is not a general clause which also prohibits the unfair labor practices described in subsequent paragraphs of subsection 8(b)." *Id.* at 806.

D. The Board's Current Approach Overlooks the Compromise Character of the Taft-Hartley Amendments to the National Labor Relations Act.

In concluding that Section 8(b)(1)(A) prohibits picketing to secure the recognition of a minority union, as with its other conclusions to which we presently turn, the Board has overlooked a vital element of the legislative process. "Legislation is often tentative, beginning with the most obvious case, and not going beyond it, or to the full length of the principle upon which its acts must be justified." Mr. Justice Holmes in *Beard* v. *Boston,* 151 Mass. 96, 97, 23 N.E. 826, 827. It is this "cautious advance, step by step, and the distrust of generalities which sometimes have been the weakness, but often the strength, of English legislation." *Carroll* v. *Greenwich Insurance Co.,* 199 U.S. 401, 411. This approach is characteristic of the Taft-Hartley amendments to the National Labor Relations Act. "It is relevant to recall that the Taft-Hartley Act was, to a marked degree, the result of conflict and compromise between strong contending forces and deeply held views on the role of organized labor in the free economic life of the Nation and the appropriate balance to be struck between the uncontrolled power of management and labor to further their respective interests. This is relevant in that it counsels wariness in finding by construction a broad policy . . . as such when, from the words of the statute itself, it is clear that those interested in just such a condemnation were unable to secure its embodiment in enacted law." *Local 1976, United Brotherhood of Carpenters* v. *N.L.R.B.,* 357 U.S. 93, 99-100. And so, in "a matter of such bitter controversy as the Taft-Hartley Act, the product of careful legislative drafting and compromise beyond which its protagonists either way could not force the main body of legislators, the courts should proceed cautiously." *Rabouin* v. *N.L.R.B.,* 195 F. 2d 906, 912 (C.A. 2). The Board in this case has isolated

a single principle, pushed it to a logical extreme, and reached a determination which Congress, fully aware of the whole range of the problem and the opposing claims and interests with which it bristles, has deliberately refrained from embracing. It is no part of the function of the Board to be "a super-Congress." [50]

II. AN APPEAL TO CUSTOMERS NOT TO PATRONIZE AN EMPLOYER AND A REQUEST TO PLACE THAT EMPLOYER ON A "WE DO NOT PATRONIZE" LIST, IN ORDER TO SECURE THAT EMPLOYER'S RECOGNITION OF A MINORITY UNION, IS NOT A VIOLATION OF SECTION 8(b)(1)(A).

We have shown that picketing to secure the recognition of a minority union is not a violation of Section 8(b)(1)(A). It follows that it cannot be a violation to appeal to customers not to patronize the employer, or to request that the employer be placed on a "We Do Not Patronize" list, in order to influence his recognition of a minority union. But even if picketing for that purpose is a violation, the customer appeals and the "We Do Not Patronize" list

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[50] *N.L.R.B.* v. *National Maritime Union*, 175 F. 2d 686, 691 (C.A. 2), cert. denied, 338 U.S. 954.

We recognize, of course, that this Court's opinion in *Capital Service, Inc.* v. *N.L.R.B.*, 204 F. 2d 848, 851-853, affirmed without reaching this question, 347 U.S. 501, contains statements inconsistent with the position we advance. We do not think these should control. (1) The issue arose in *Capital Service* in the context of determining whether certain activity which the state court undertook to regulate was preempted by the federal statute. To find preemption it is necessary only to determine that the conduct in controversy may *reasonably* be deemed to be within the purview of the national act. *Weber* v. *Anheuser-Busch, Inc.*, 348 U.S. 468, 478-479, 480, 481; *Aetna Freight Lines* v. *Clayton*, 228 F. 2d 385, 388 (C.A. 2), cert. denied, 351 U.S. 950. Since this Court's holding that the conduct was preempted requires no more than a determination that the activity is reasonably cognizable as an unfair labor practice, the decision does not commit the Court on the merits of the unfair labor practice question. (2) In its petition for rehearing in *Capital Service*, the Board observed that this Court reached its conclusions as to the scope of Section 8(b)(1)(A) without benefit of briefs or argument on the issue (pp. 1-3), and the petition itself did little more than to adumbrate the relevant considerations. It is fair to say that, not until this case, has the Court been presented with a full canvassing of either side of the issue. We therefore venture to suggest that if the Court is otherwise disposed to accept our position, *Capital Service* should not stand in the way. (3) *Capital Service* is factually distinguishable. It pertained to picketing the premises of the customers of the employer from whom the union sought recognition. It did not, as here, concern picketing of the employer's own premises. To enjoin such picketing is a distinct advance beyond *Capital Service*.

are not. Congress has not authorized, the Constitution would forbid, condemnation of these means.

A. Congress Has Not Authorized Condemnation of Customer Appeals or the "We Do Not Patronize" List.

We begin with the direct appeals to customers not to patronize the employer who declines to recognize the minority union. Again our starting point is a provision of the statute which deals explicitly with the subject. Section 8(b)(4)(B) makes it an unfair labor practice for a labor organization or its agents to engage in, or to induce or encourage the employees of "any employer" to engage in, a strike or a concerted refusal to work, "where an object thereof is":

> forcing or requiring any *other* employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has been certified as the representative of such employees under the provisions of section 9. (Emphasis supplied.)

In this case Alloy's customers are "any employer"; Alloy is "any other employer." And Section 8(b)(4)(B) defines precisely the action to which Alloy's customers—"any employer"—may not be subjected "where an object thereof" is "forcing or requiring" Alloy—"any other employer"—"to recognize or bargain with a labor organization as the representative of his employees. . . ." The proscribed action is to call a strike among the employees of Alloy's customers or to induce or encourage them to strike.[51] But except as a strike of their *employees* is called, or their *employees* are induced to strike, Section 8(b)(4)

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[51] This action is, however, permissible if, in the statutory language, the labor organization whose recognition is sought "has been certified as the representative. . . ." S. Rep. No. 105, 80th Cong., 1st Sess., 22, in 1 Leg. Hist. 428; H. Conf. Rep. No. 510, 80th Cong., 1st Sess., 43, in 1 Leg. Hist. 547; *DiGiorgio Fruit Corp.*, 87 NLRB 720, 748-749, affirmed, 191 F. 2d 642 (C.A.D.C.), cert. denied, 342 U.S. 869; *Sailors' Union of the Pacific*, 92 NLRB 547, 568-569.

(B) prohibits no other means of influencing conduct by Alloy's customers.[52] And so, as the Supreme Court has held, "a union is free to approach an employer to persuade him to engage in a boycott, so long as it refrains from the specifically prohibited means of coercion through inducement of employees." *Local 1976, United Brotherhood of Carpenters* v. *N.L.R.B.,* 357 U.S. 93, 99.

That is all that happened in this case when the Union appealed to several of Alloy's customers not to patronize Alloy. It simply exercised its freedom "to approach an employer to persuade him to engage in a boycott. . . ." This is precisely what Section 8(b)(4)(B) allows; for when it defines what a union may not do, it equally declares what a union may do, to force or require "any other employer to recognize or bargain with a labor organization. . . ." See *Garner* v. *Teamsters Union,* 346 U.S. 485, 499-500; *N.L.R.B.* v. *Local 50, Bakery & Confectionary Workers Union,* 245 F. 2d 542, 548 (C.A. 2). It is not a possible interpretation to say that what Congress allowed under Section 8(b)(4)(B) it just as promptly disallowed under Section 8(b)(1)(A).

The "We Do Not Patronize" list is in the same class. All that the Union did was to request the Spokane Central Labor Council to place Alloy on the list. The list was published in the "Labor World," the Council's periodic publication. The consequence of the Council's agreement to list Alloy was to appeal to those among whom the publication circulated not to buy Alloy's products. The published list differs from the direct customer appeals only in that it reaches a different part of the consuming public and the medium of appeal is written rather than spoken.

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[52] *Rabouin* v. *N.L.R.B.*, 195 F. 2d 906, 911 (C.A. 2); *N.L.R.B.* v. *Business Machine and Office Appliance Mechanics*, 228 F. 2d 553, 559 (C.A. 2), cert. denied, 351 U.S. 962; *Peter D. Furness*, 117 NLRB 437, 459, enforced, 254 F. 2d 221 (C.A. 3); *Arkansas Express, Inc.*, 92 NLRB 254, 265; *Santa Ana Lumber Co.*, 87 NLRB 937, 941-942. This settled interpretation was pioneered by this Court in *Schatte* v. *International Alliance*, 182 F. 2d 158, 165 (C.A. 9), cert. denied, 340 U.S. 827.

Like the direct appeal, it violates no provision of the Act. The Board has uniformly held that "a general public appeal for a consumer boycott" does "not violate the Act." [53] So have the courts.[54] And the Supreme Court's recent decision in *Local 1976, United Brotherhood of Carpenters* v. *N.L.R.B.*, 357 U.S. 93, 98-101, is complete confirmation. As Senator Taft stated in a question-and-answer explanation inserted in the Congressional Record (93 Cong. Rec. A3370):

> Question. Suppose the union, instead of refusing to handle his [the nonunion employer's] goods in other plants, urges the general public not to buy products of nonunion manufacturers?
> Answer. This is not forbidden by the act, since it is merely persuasion.

We do not understand the alchemy by which the Board, in order to bring the consumer appeals within the Board's engulfing concept of Section 8(b)(1)(A), converts this persuasion into the Union's utilization of "economic power" (R. 22). The Union exerts no economic power over the readers of the Labor World or the customers to whom it appeals directly. If the consumers are persuaded not to buy Alloy's products, it is much more logical to speak of the consumers' exercise of their economic power. But the Act does not illegalize their withholding of patronage, and it is as licit for the Union to persuade them to do so.

Here indeed is the minimum basis for the application of Secton 8(c) of the Act if it is to extend any meaningful protection to labor organizations. For surely the customer appeals and the "We Do Not Patronize" list are

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[53] *United Brewery Workers*, 121 NLRB No. 35, sl. op. p. 8, 42 LRRM 1350, 1353. See also, *Dallas General Drivers*, 118 NLRB 1251, 1254-1255; *Consolidated Frame Co.*, 91 NLRB 1295, 1299.

[54] *N.L.R.B.* v. *Business Machine and Office Appliance Mechanics*, 228 F. 2d 553, 559-561 (C.A. 2), cert. denied, 351 U.S. 962; *Douds* v. *Local 50, Bakery & Confectionary Workers Union*, 224 F.2d 49, 51, n. 4 (C.A. 2); *N.L.R.B.* v. *Crowley's Milk Co.*, 208 F. 2d 444, 446-447 (C.A. 3), enforcing, 102 NLRB 996, 998; *N.L.R.B.* v. *Service Trade Chauffeurs*, 191 F. 2d 65, 68 C.A. 2); *Getreu* v. *Hatters Union*, 41 LRRM 2429 (D.C.W.D. Ky.)

in pure form the "expressing" and "dissemination" of "views, argument, or opinion," which are not to "constitute or be evidence of an unfair labor practice under any of the provisions of this Act. . . ." As the Supreme Court has said, "A boycott voluntarily engaged in by a secondary employer for his own business reasons, perhaps because the unionization of other employers will protect his competitive position or because he identifies his own interests with those of his employees and their union, is not covered by the statute." *Local 1976, United Brotherhood of Carpenters* v. *N.L.R.B.*, 357 U.S. 93, 98-99. The least that Section 8(c) can mean is to safeguard a union's right to attempt to persuade an employer to identify his interests with its. The same is true of every other element of the consumer public. The Union cannot be less free to urge customers not to buy the product of a nonunion firm than that firm is free to urge the public to patronize it despite its nonunion status.

The merest adumbration of these considerations, which we elaborate hereafter, discloses why Congress in Section 8(b)(4) restricted the means it prohibited to strikes and inducements to strike, and why it made assurance doubly certain by adopting Section 8(c). Congress did not at the same time unlid Pandora's box by enacting the Board's freewheeling concept of Section 8(b)(1)(A). As we presently show, had Congress indeed intended to prohibit customer appeals and publication of "We Do Not Patronize" lists, the enactment could not survive the Constitution's guarantee of freedom of speech and press. At the least the doubts are grave. This is relevant to the question of statutory interpretation. For it is elementary that that interpretation is to be adopted which avoids constitutional doubts.[55]

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[55] *United States* v. *Rumley*, 345 U.S. 41, 45-46; *Peters* v. *Hobby*, 349 U.S. 331, 338; *United States ex rel. Attorney General* v. *Del. & Hudson Co.*, 213 U.S. 366, 407-408.

B. The Constitutional Protection of Freedom of Expression Prohibits Condemnation of Customer Appeals and the "We Do Not Patronize" List.

The Board would avoid the constitutional objection to prohibiting customer appeals and the "We Do Not Patronize" list by assimilating them to picketing (R. 22-23). "This is to make situations that are different appear the same."[56] The prohibition of picketing upon the basis of standards less rigorous than those applicable to pure speech is permissible precisely because it differs from "Publication in a newspaper, or by distribution of circulars. . . ." *Hughes* v. *Superior Court,* 339 U.S. 460, 465. For picketing does "exert influences, and it produces consequences, different from other modes of communication," and the responses it evokes "are unlike those flowing from appeals by printed word." *Ibid.* There is therefore no constitutional compulsion to place picketing "on a par" with other means of publicity. *International Brotherhood of Teamsters* v. *Hanke,* 339 U.S. 470, 476-477. But to converse with a customer to persuade him not to buy is pure speech. And to request the Labor Council to put Alloy on the "We Do Not Patronize" list, which is published in and circulated among the readers of "Labor World," is indistinguishable from placing an advertisement in a newspaper. We deal therefore with pristine expression. Having downgraded the constitutional protection of picketing because of "the ingredients in it that differentiate it from speech" (*Hughes* v. *Superior Court,* 339 U.S. 460, 465), it is not possible now to downgrade speech in order to justify its prohibition on the basis of the lesser standards applicable to picketing.

Since we deal with pure expression, it is relevant to remind that "only considerations of the greatest urgency can justify restrictions on speech. . . ." *Speiser* v. *Randall,* 357 U.S. 513, 521. "The question in every case is whether the words used are used in such circumstances and are of

[56] *Ray Brooks* v. *N.L.R.B.,* 348 U.S. 96, 104.

such a nature as to create a clear and present danger that they will bring about the substantive evils that Congress has a right to prevent." *Schenck* v. *United States,* 249 U.S. 47, 52. Or, as restated, "In each case [courts] must ask whether the gravity of the 'evil,' discounted by its improbability, justifies such invasion of free speech as is necessary to avoid the danger." *Dennis* v. *United States,* 341 U.S. 494, 510.

The Board brief would meet the issue by defining the substantive evil to be immediate recognition of a minority union, and by arguing that, as achievement of this end is the objective of the customer appeals and the "We Do Not Patronize" list, they are beyond the constitutional pale because they incite disobedience of law (Bd. br. pp. 37-39). The argument rushes to its conclusion too fast. There is no disobedience of law incited. It is entirely legal for the customers to whom the appeal is addressed to withhold their patronage from Alloy. The persuasion directed to them to do so seeks of them nothing but their performance of a lawful act. Since the act induced is lawful it is not possible to justify abridgment of speech on the ground that it counsels violation of law. And illegal action aside, freedom of expression safeguards "the opportunity to persuade to action, not merely to describe facts." *Thomas* v. *Collins,* 323 U.S. 516, 537.

Furthermore, even if an ultimate consequence of successful consumer resistance to buying Alloy's products may be to induce Alloy to recognize the Union while it still does not have a majority, this does not establish a valid basis for prohibiting the customer appeals and the "We Do Not Patronize list, nor does it denigrate the obvious unimpeachable end that such persuasion does serve. That end is avowedly "to use every means possible to inform the public that the Alloy Manufacturing Company do[es] not employ union help and that the existing conditions governing employment are unfair to organized labor" (R.

37-38; 130). That Alloy and its employees may prefer to remain nonunion does not detract from the threat to the welfare of organized labor that the firm's nonunion status exerts. "Unions obviously are concerned not to have union standards undermined by non-union shops." *International Brotherhood of Teamsters* v. *Hanke,* 339 U.S. 470, 475. "The interdependence of economic interest of all engaged in the same industry has become a commonplace." *American Federation of Labor* v. *Swing,* 312 U.S. 321, 326. For union organization to be "at all effective, employees must make their combination extend beyond one shop. It is helpful to have as many as may be in the same trade in the same community united, because, in the competition between employers, they are bound to be affected by the standard of wages of their trade in the neighborhood. Therefore, they may use all lawful propaganda to enlarge their membership, and especially among those whose labor at lower wages will injure their whole guild." *American Steel Foundries* v. *Tri-City Central Trades Council,* 257 U.S. 184, 209. And since, "in order to render a labor combination effective it must eliminate the competition from non-union made goods . . ., an elimination of price competition based on differences in labor standards is the objective of any national labor organization." *Apex Hosiery Co.* v. *Leader,* 310 U.S. 469, 503. Indeed, the policy of the National Labor Relations Act is based on explicit recognition that an evil against which the statute is directed is "preventing the stabilization of competitive wage rates and working conditions within and between industries" (Sec. 1, para. 2).

Thus, when a union publicizes the nonunion status of a firm, and urges consumers not to buy its products, it is exercising its freedom of expression to support a valid economic interest. The Union is as free to communicate Alloy's nonunion status to consumers as Alloy is free to urge those same consumers that this is not a consideration

which should deter them from buying Alloy's products. It is for the community of consumers in which Alloy and the Union both operate to decide on which side the consumer chooses to align himself. As the trial examiner properly observed in this case, "It is true that business operations employing union labor will be preferred by some customers and avoided by others upon the basis of that factor" (R. 44). The only meaning of free speech is that Alloy and the Union may both seek their customer support by appealing for it. That may mean that, if the Union's propaganda wins enough adherents among the consumers, the business pinch that Alloy and its employees may then feel may cause them to reconsider the wisdom of their nonunion preference. The employees may choose, and Alloy is free to persuade them to choose, union representation. If the employees prefer retention of their non-union status to alleviation of the pinch, that too is their right, but it is just as much the right of the Union to continue to persuade the consumers to shun the nonunion product. Unless free speech is a cloistered concept, again its only real meaning is that each element of the population is free to exercise it to win the support of others. There is in our society no escape for anyone, consistent with constitutional protection for all, from the interacting influence of the different reactions of different elements of our reticulated community.

The point can be illustrated by an example about which there should be no doubt. Labor organizations commonly conduct campaigns urging consumers to buy union-made goods, whether these be hats, suits, or preglazed sash. The necessary consequence of success is to reduce the purchase of nonunion goods, with consequent economic pinch of nonunion firms. Would anyone suggest that union propaganda to purchase union-made goods can be prohibited? There is no constitutional difference between the example and this case. Persuasion to purchase union-made goods is neces-

sarily persuasion not to purchase nonunion goods, and the only added feature in this case is that the customer appeals and the "We Do Not Patronize" list identified the specific nonunion firm. The difference hardly supports suppression of speech. Communication by "employees of the facts of a dispute, deemed by them to be relevant to their interests, can[not] . . . be barred because of concern for the economic interests against which they are seeking to enlist public opinion. . . ." *American Federation of Labor* v. *Swing,* 312 U.S. 321, 326. It is noteworthy that, in sanctioning the prohibition of picketing in *International Brotherhood of Teamsters* v. *Hanke,* 339 U.S. 470, the Supreme Court observed that the permitted restraint left "all other channels of communication open to the union" (*id.* at 477). Similarly, in sanctioning the restriction of picketing in *Carpenters & Joiners Union of America* v. *Ritter's Cafe,* 315 U.S. 722, the Supreme Court observed that it "leaves open to the disputants other traditional modes of communication" (*id.* at 728). And the prohibition of picketing sanctioned in *Building Service Employers Union* v. *Gazzam,* 339 U.S. 532, did not disturb the employer's placement on a "We Do Not Patronize" list (*id.* at 534). The "publication, unaccompanied by violence, of a notice that the employer is unfair to organized labor and requesting the public not to patronize him is an exercise of the right of free speech guaranteed by the First Amendment which cannot be made unlawful by act of Congress." Mr. Justice Stone concurring in *U.S.* v. *Hutcheson,* 312 U.S. 219, 243.

Finally, even if it were possible to identify a substantive evil, there is no showing that the customer appeals and the "We Do Not Patronize" list have that immediacy which would justify their suppression as a clear and present danger. There is no finding, nor evidence that would support a finding, that the evil apprehended is capable of imminent realization because of the speech. On the

contrary, despite the concomitant picketing, Alloy refrained from recognizing the Union although the customer appeals and the "We Do Not Patronize" list had been in being for a year. Furthermore, the "We Do Not Patronize" list is circulated among the readers of the "Labor World." Since that is a labor publication, it is fair to infer that its readers are principally workers. Alloy manufactures truck bodies, semi-trailers and similar products (R. 36; 8-9, 13). We find it hard to imagine that among a consumer class made up of workers Alloy runs much risk of impairment of its market for truck bodies, semi-trailers and similar products. This leaves the direct appeals to Alloy's customers. But there was no showing by reliable evidence—comparative profit and loss statements, sales volume, or individual customer ledger sheets—of any diminution of business. At most there may have been irksome inconvenience to Alloy in the operation of its business, but the least hospitable view of the protection enjoyed by freedom of expression could not find in this the proximity of danger, the gravity of evil, and the necessity of suppression which would alone justify prohibition of the Union's customer appeals and its request to place Alloy on the "We Do Not Patronize" list.

III. EXCEPT FOR THE FINDING THAT THE UNION VIOLATED SECTION 8(b)(2) OF THE ACT BY PICKETING TO SECURE A UNION SHOP AGREEMENT WHEN IT HAD NO MAJORITY, THE REMAINING BASES UPON WHICH THE BOARD FOUND STATUTORY VIOLATIONS ON THE UNION'S PART ARE WITHOUT MERIT.

We turn now to the remaining bases upon which the Board would find statutory violations on the Union's part.

1. The Board found that the Union's "picketing activity aimed at winning a union shop from Alloy Company despite the Union's minority status constituted a violation of Section 8(b)(2) of the Act" (R. 19-20, 42-43). We agree that an insistent demand for a union shop agree-

ment, backed by picketing to support it, when a union does not represent a majority, is a violation of Section 8(b)(2) of the Act, in that it is an "attempt to cause an employer to discriminate against an employee in violation of subsection (a)(3)...." [57] We read the Board's findings to amount to this (R. 36-39), and we agree that there is substantial evidence to support the findings. We therefore acquiesce in the entry of a decree enforcing the Board's order insofar as it requires the Union to cease and desist from "Attempting to cause Alloy, by means of picketing . . ., to discriminate against Alloy's employees in violation of Section 8(a)(3) of the Act" (R. 25).[58]

2. This conduct—picketing to back an insistent demand for entry into an invalid union shop agreement—although it supports a finding of a violation of Section 8(b)(2), does not, contrary to the Board (R. 20), furnish an independent basis for finding a violation of Section 8(b)(1)(A). The Court of Appeals for the Seventh Circuit has explicitly so held,[59] affirming the Board's determination in this respect,[60]

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[57] *Garner* v. *Teamsters Union*, 346 U.S. 485, may properly be cited to support the conclusion that picketing to secure entry into an invalid union shop agreement, because it constitutes an attempt to cause discrimination in employment, violates Section 8(b)(2) of the Act. But the Board's mistaken reliance on *Garner* to show that picketing to secure the recognition of a minority union violates Section 8(b)(1)(A) is amply exposed in Board Member Murdock's dissent in *Curtis* (Bd. br. pp. 97-98). It is noteworthy that the Board brief does not cite *Garner* to support an 8(b)(1)(A) violation.

[58] The deletion indicated by the ellipsis omits from the order the phrase "or by threatening to divert business from Alloy." This part of the order is improper. It is based on the subsidiary finding that, "in urging Alloy to recognize it and to sign the contract, the . . . [Union] threatened that failure to do so would result in action to persuade suppliers, customers, and transporters no longer to do business with Alloy" (R. 39). As we have shown, however, it was lawful for the Union to appeal to customers not to patronize Alloy. That is all that is comprised in the so-called threat to divert business from Alloy. "Ordinarily, what you may do without liability you may threaten to do without liability." Mr. Justice Holmes in *Silsbee* v. *Weber*, 171 Mass. 379, 380. "How then can it be said that a warning [by the Union] of what . . . [it] had a right to do, without notice, constituted an unfair labor practice?" *Kansas Milling Co.* v. *N.L.R.B.*, 185 F. 2d 413, 420 (C.A. 10).

[59] *American Newspaper Publishers Association* v *N.L.R.B.*, 193 F. 2d 782, 801, 806 (C.A. 7), cert. denied, 344 U.S. 812.

[60] *International Typographical Union*, 86 NLRB 951 957.

the Board having reversed the examiner's contrary conclusion.[61] This has been the uniform course of interpretation until discarded in this case (*supra*, pp. 33-35, and n. 44, ¶2. The only basis for the present about-face advanced by the Board is that "Concession by an employer of a union shop agreement to a union necessarily presupposes recognition of that union as the exclusive representative of all the employees, and [the] . . . same underlying considerations . . . leading to the conclusion that picketing for exclusive recognition restrains and coerces within the meaning of Section 8(b)(1)(A), apply with equal force to picketing by a minority union for purposes of obtaining a union shop agreement" (R. 20). As we have shown, picketing to secure the recognition of a minority union is not a violation of Section 8(b)(1)(A). Since the premise of the Board's argument falls, the argument falls with it. Furthermore, since full relief from picketing to secure entry into a union shop agreement with a minority union is secured through the avenue of Section 8(b)(2), it is pointless to warp the interpretation of Section 8(b)(1)(A) to achieve a result which is academic only.

3. There remains the question whether, insofar as a purpose of the Union was to secure entry into a union shop agreement when it had no majority, this added feature justifies the Board's conclusion that for this reason the customer appeals and the "We Do Not Patronize" list violate both Section 8(b)(1)(A) and 8(b)((2) (R. 52). For the purpose of Section 8(b)(1)(A) entry into a union shop agreement with a minority union adds nothing to recognition of a minority union. Since the latter does not furnish a basis for finding that the customer appeals and the "We Do Not Patronize" list violate Section 8(b)(1)(A), neither does the former.

[61] *Id.* at 1013.

The same is true of Section 8(b)(2). The statutory and constitutional immunity of an appeal for consumer support is identical regardless of the subsection of the statute under which it is sought to be interdicted. Indeed, the legislative history of Section 8(b)(2) is especially illuminating. As originally passed by the Senate, the words employed in 8(b)(2) were "to persuade or attempt to persuade an employer." H.R. 3020, 80th Cong., 1st Sess., Sec. 8(b)(2) (May 13, 1947)), in 1 Leg. Hist. 239-240. These words were changed in conference to "cause or attempt to cause" in order to make the language consistent "with the provisions guaranteeing all parties freedom of expression." 93 Cong. Rec. 6443, in 2 Leg. Hist. 1539. And so, as the examiner correctly concluded in this case, "I do not doubt the right of the . . . [Union] to publicize by appropriate means the fact that Alloy's employees are not represented by a union and even to persuade others by peaceful and truthful propaganda not to patronize Alloy for that reason if the persuasion is attempted to be accomplished by no more than the expression of 'views, argument, or opinion' " (R. 45). The customer appeals and the "We Do Not Patronize" list are in this class. Section 8(c) protects them and the Constitution would if Section 8(c) did not.

IV. THE BOARD'S ORDER IS TOO BROAD IN PROVIDING A BLANKET PROHIBITION AGAINST "RESTRAINING AND COERCING EMPLOYEES OF ALLOY MANUFACTURING COMPANY IN THE EXERCISE OF THE RIGHTS GUARANTEED IN SECTION 7 OF THE ACT."

Upon the assumption that the Board properly found a violation of Section 8(b)(1)(A) of the Act, its order is too broad in providing a blanket prohibition against "Restraining or coercing employees of Alloy Manufacturing Company in the exercise of the rights guaranteed in Section 7 of the Act" (R. 24). So uncircumscribed an order is at war with the principle that "To justify an order restraining other violations it must appear that they bear

some resemblance to that which the . . . [wrongdoer] has committed or that danger of their commission in the future is to be anticipated from the course of his conduct in the past." *N.L.R.B.* v. *Express Publishing Co.,* 312 U.S. 426, 437. The order as it now reads encompasses within its sweep such conduct as "assaults and batteries on nonstriking employees; stoning, clubbing, and attempting to overturn automobiles of nonstrikers; threats of physical violence; and erecting barriers to plant entrances during picketing." N.L.R.B., Fifteenth Annual Report, 127 (1950). Nothing in the Union's activity in this case furnishes the slightest justification for an order which reaches such conduct. Furthermore, the Board's interpretation of the scope of Section 8(b)(1)(A) does not confine it to picketing and consumer appeals to secure recognition of and entry into a union shop agreement with a minority union. It extends to any activity which, upon a "balancing of the conflicting legitimate interests," the Board would find does not justify the alleged restraint. (Bd. br. pp. 27-30, 59-61.) Thus the order requires the Union to refrain from violations which are unknown and unknowable because they are still within the bosom of the Board. "A party is entitled to a definition as exact as the circumstances permit of the acts which he can perform only on pain of contempt of court." *J. I. Case Co.* v. *N.L.R.B.,* 321 U.S. 332, 341. Finally, the acts now found to be prohibited by Section 8(b)(1)(A) were for the first ten years of the administration of the Taft-Hartley Act uniformly found not to be within that section's purview. The doing of acts which, until the very case in which they were for the first time condemned, had theretofore been found to be beyond the section's scope, hardly shows that predilection for disobedience of the law which would justify an order extending to any and all of the dissociated offenses which the section reaches. The order should have been confined to the conduct found to violate Section 8(b)(1)(A). The "decree of enforcement should not extend

further than necessary to prevent the taking of the prohibited action. . . .'' *N.L.R.B.* v. *Crompton-Highland Mills, Inc.,* 337 U.S. 217, 226.

CONCLUSION

For the reasons stated, except to enforce that part of the Board's order which requires the Union to cease and desist from ''Attempting to cause Alloy, by means of picketing . . ., to discriminate against Alloy's employees in violation of Section 8(a)(3) of the Act'' (*supra,* pp. 52-53), the Board's petition for enforcement should be denied.

Respectfully submitted,

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APPENDIX

I

In addition to the bills discussed *supra* pp. 15-18, the following bills pertaining to recognition picketing were also introduced in the 85th Congress, 2nd Session:

1. H.R. 10101 (Jan. 20, 1958). This bill would amend Section 8(b) of the Taft-Hartley Act to make it an unfair labor practice for a union:

> (7) to engage in picketing on or about the premises of any employer for the purpose of organizing any of the employees of such employer or for the purpose of forcing or requiring such employer to recognize such labor organization as the representative of his employees, unless prior thereto such labor organization shall have obtained the approval in writing of at least 33-1/3 per centum of the employees of such employer of the class or classes which such labor organization is attempting to organize or represent.

The foregoing bill was also introduced as S. 3047 (Jan. 16, 1958), and it was likewise proposed as an amendment to S. 3974 on June 13, 1958.

2. S. 2927 (Jan. 9, 1958). This bill would amend Section 8(b) of the Taft-Hartley Act to make it an unfair labor practice:

> (7) to carry on picketing on or about the premises of any employer either for organizational purposes or for the purpose of forcing or requiring such employer to recognize or bargain with a labor organization as the representative of his employees if (A) another labor organization has been certified as the representative of such employees under section 9(c) within the preceding twelve-month period, (B) an election has been held under section 9(c) within the preceding twelve-month period and no labor organization has been certified as the representative of such employees, or (C) a petition has been filed under Section 9(c)(1)(A) by another labor organization or under section

9(c)(1)(B) by such employer, and such petition is pending before the Board.

3. S. 3618 (April 15, 1958). Section 201 of this bill would amend Section 8(b) of the Taft-Hartley Act to make it an unfair labor practice for a union:

> (7) to carry on picketing on or about the premises of any employer, prior to the holding of an election as provided under section 9(c), for organizational purposes or for the purpose of forcing or requiring such employer to recognize or bargain with a particular labor organization as the representative of his employees unless there shall have been filed with such employer at least five days before the commencement of any such picketing a petition signed by at least two-thirds of the employees of such employer (not counting any employee employed by such employer after beginning of the labor dispute in question) requesting that such employer recognize as the representative of his employees a particular labor organization designated in such petition.

II

Since the enactment of Section 8(b)(4)(C) by the 80th Congress, and excluding the bills already described that were introduced in the 85th Congress, 2nd Session, the following bills pertaining to recognition picketing were introduced in intervening Congresses.

1. H.R. 2032, 81st Cong., 1st Sess. (Jan. 31, 1949). This bill would repeal the Taft-Hartley Act, reenact the Wagner Act, and amend Section 8 of the Wagner Act to provide that:

> (b) It shall be an unfair labor practice for a labor organization—
>
> (1) to cause or attempt to cause employees to engage in a secondary boycott, or a concerted work stoppage, to compel an employer to bargain with a particular labor organization as the representative of his employees if—

(a) another labor organization is the certified representative of such employees within the meaning of section 9 of this Act; or

(b) the employer is required by an order of the Board to bargain with another labor organization; or

(c) the employer is currently recognizing another labor organization (not established, maintained, or assisted by any employer action defined in this Act as an unfair labor practice) and has executed a collective-bargaining agreement with such other labor organization, and a question concerning representation may not appropriately be raised under section 7 of this Act.

Other bills identical to the foregoing were introduced in that and succeeding Congresses: H.R. 4811, 81st Cong., 1st Sess., Sec. 208(b)(2) (May 23, 1949); S. 249, 81st Cong., 1st Sess., Sec. 106(d) (Jan. 31, 1949); H.R. 1311, 83d Cong., 1st Sess., Sec. 106(d) (Jan. 7, 1953); H.R. 3533, 83rd Cong., 1st Sess., Sec. 2(4), Feb. 26, 1953; H.R. 216, 84th Cong., 1st Sess., Sec. 106(d) (Jan. 5, 1955); H.R. 1000, 85th Cong., 1st Sess., Sec. 106(d) (Jan. 3, 1957). A bill to like effect, but not identically worded, is H.R. 4914, 81st Cong., 1st Sess., Sec. 8(a)(4)(B) (May 31, 1949). See also, S. Rep. No. 99, 81st Cong., 1st Sess., 59, 67-68, Minority Views, 29.

2. H.R. 4795, 83rd Cong., 1st Sess. (April 22, 1953.) This bill would prohibit any recognition strike or picketing except to secure the recognition of a certified union.

3. S. 1311, 83d Cong., 1st Sess. (March 13, 1953.) This bill would amend Section 8(b)(4)(C) to read as follows:

(C) forcing or requiring any employer to recognize or bargain with a labor organization as the representative of his employees (1) if another labor organization has been certified as the representative of such employees under the provisions of section 9, or (2), if, prior to such strike or concerted refusal, a petition has been filed under section 9(c)(1) by another labor organization requesting certification as the representative of such employees under the provisions of section 9, and such petition is pending before the board.

No. 15814

In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

INTERNATIONAL ASSOCIATION OF MACHINISTS, LODGE 942, AFL–CIO, RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

REPLY BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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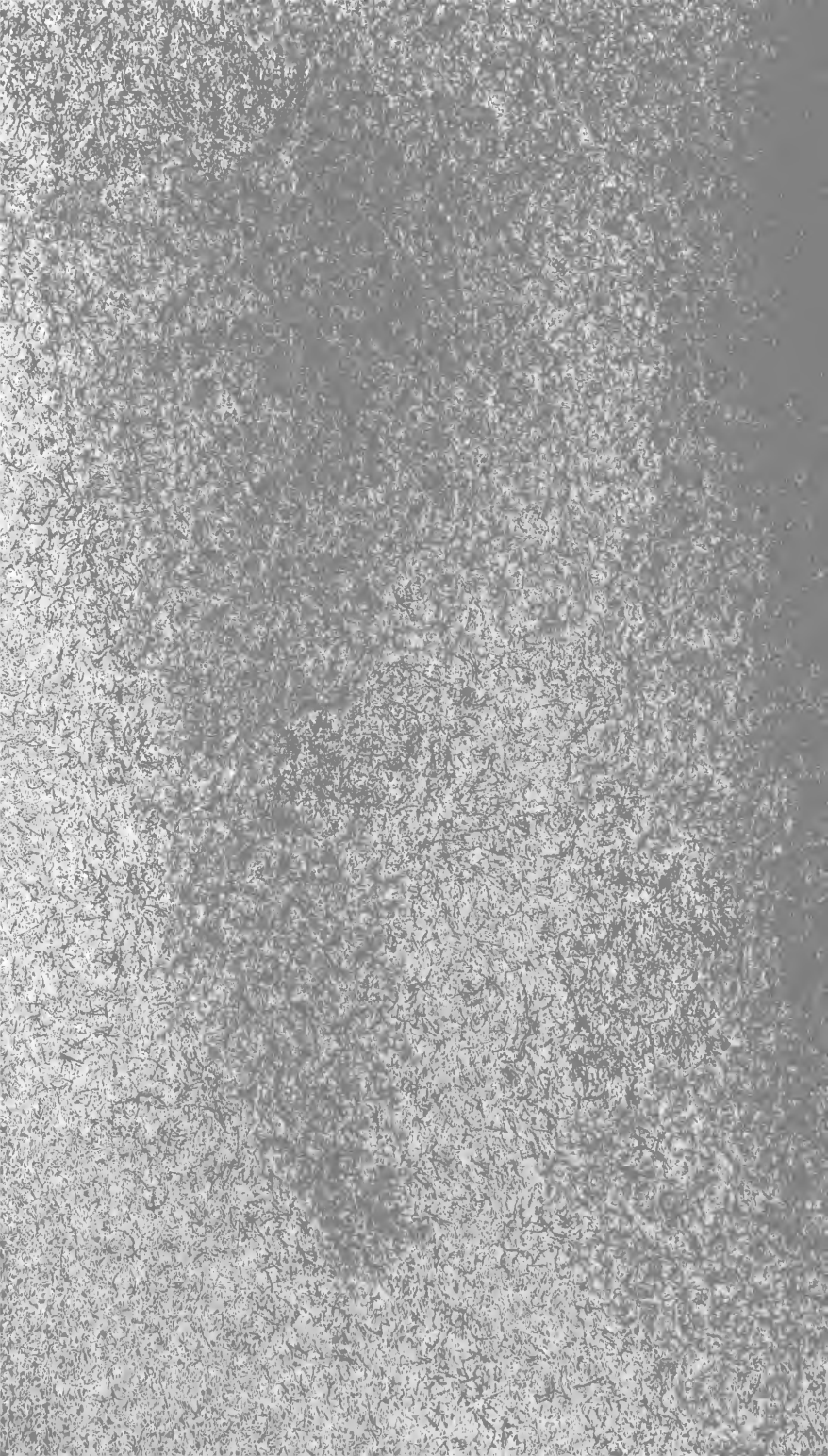

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In its brief the Union does not contest the Board's findings that the two-fold object of its picketing and other conduct was to obtain from Alloy recognition as the exclusive bargaining agent of its employees, and a contract compelling membership in the Union as a condition of employment. Nor does the Union contest the further finding that it did not represent a majority of Alloy's employees during the events in this case, so that accession to these objectives by Alloy would have resulted in unfair labor practices on its part. The Union nevertheless contends that it committed no unfair labor practices, except insofar as it sought, by its picketing, to obtain a union shop—which conduct the Union concedes (br. 53) the Board

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properly found to be violative of Section 8 (b) (2) of the Act.

It is the Union's position, first, that picketing to compel immediate recognition on behalf of a union which does not represent a majority of the employees does not restrain or coerce employees within the meaning of Section 8 (b) (1) (A)—a position which it acknowledges (br. 42, n. 50) is contrary to the reasoning of this Court's decision in *Capital Service, Inc.* v. *N. L. R. B.,* 204 F. 2d 848. Second, the Union contends that the use of a "We Do Not Patronize" list is in any event distinguishable from picketing, so that, insofar as it sought to further its objectives by the former means, not even the finding of an 8 (b) (2) violation is warranted. Finally, the union contests the breadth of the Board's order.

In this reply brief, we shall address ourselves to those of the Union's arguments, on each of these phases of the case, which were not fully anticipated in our opening brief.

I. The contention that the Union's picketing did not violate Section 8 (b) (1) (A) of the Act

A. The Union's conclusion that recognition of picketing by a minority union is not violative of Section 8 (b) (1) (A) rests principally on the argument that "By Section 8 (b) (4) (C) Congress has expressed the sole extent to which it intends to regulate as an unfair labor practice picketing by a union of an employer to secure that employer's recognition of it * * *" (br. 9). The history of Sections 8 (b) (4) (C) and 8 (b) (1) (A), however, reveals just the opposite.

Thus, Section 8 (b) (4) (C) was contained in the Senate bill as it was reported out of committee, while Section 8 (b) (1) (A) was not. S. 1126, 80th Cong., 1st Sess., p. 15, I Leg. Hist. 113. Accordingly, the most that may be inferred from Section 8 (b) (4) (C), when it appeared as part of the Senate bill, is that it went as far as a majority of the *Senate Labor Committee* thought Congress should go in regulating union efforts to compel recognition. But five members of the Committee—including Senators Taft and Ball—were dissatisfied with the reported bill because they believed it was not stringent enough in its regulation of some union activities. They filed a statement of Supplemental Views in which they advised that they would seek amendments on the floor, including one similar to the present Section 8 (b) (1) (A). S. Rep. 105, 80th Cong., 1st Sess., p. 50–56, I Leg. Hist. 456–462. And they indicated that their purpose in seeking the latter amendment (see Bd. br. 22–23) was to outlaw conduct on the part of unions, which, if engaged in by an employer, would be violative of Section 8 (a) (1).

Moreover, in the debates on Section 8 (b) (1) (A), the sponsors of the provision made clear that one of the situations intended to be covered thereby was where a union resorted to economic pressure for the purpose of foisting itself upon employees who did not want to be represented by it (see Bd. br. 25–26). Indeed, since an employer violates Section 8 (a) (1) if he grants exclusive recognition to a minority union (Bd. br. 23), encompassing union pressure to obtain this illegal object was essential to give 8 (b) (1) (A) the equivalence in scope sought by its sponsors.

In these circumstances, the adoption of Section 8 (b) (1) (A) on the Senate floor, as an amendment to the Committee bill, can only be viewed as an enlargement upon the provisions of the bill as reported by the Senate Committee—including Section 8 (b) (4) (C).[1] And, since the Senate bill as thus amended was the bill ultimately adopted by both Houses, this conclusion respecting the relation between Sections 8 (b) (1) (A) and 8 (b) (4) (C) carries over to the law as enacted. The fact that Section 8 (b) (1) (A) was intended to augment the provisions of Section 8 (b) (4) (C), insofar as union efforts to compel recogni-

[1] Contrary to the Union's contention (br. 36–40), Section 8 (b) (4) (C) does not become redundant if Section 8 (b) (1) (A) were construed to cover union efforts to compel recognition. As we have shown (Bd. br. 31–34), the two provisions have different roles to play. In Section 8 (b) (4) (C) Congress sought to protect the integrity of an outstanding Board certification against economic attacks by a rival union. That is, until revoked under the peaceful procedures of the Act (e. g., a decertification proceeding under Section 9 (c)), the certification was entitled to presumptive validity, even though the rival union may have, in the meantime, succeeded in winning a majority of the employees away from the certified union. In short, Section 8 (b) (4) (C) would bar picketing for recognition even by a majority union—a not infrequent situation where the outstanding certification is of several years duration. On the other hand, Section 8 (b) (1) (A) applies where there is no outstanding certification and the union seeking recognition does not represent a majority of the employees.

Nor is there substance to the Union's further contention (br. 37) that "the view that Section 8 (b) (4) (C) prohibits majority strikes or picketing for recognition in the face of an unrescinded certification of a minority union commands the assent of only two of the five members of the Board." In the *Paint Makers* (*Andrew Brown*) case, cited by the Union (br. 37, n. 46), four members of the Board specifically adopted this view.

tion were concerned, is confirmed, furthermore, by the House conferees. They acceded to Section 8 (b) (1) (A) of the Senate Bill upon the assumption that the provisions of Section 12 (a) of the House bill, which outlawed in specific terms, *inter alia,* minority picketing for recognition, were unnecessary because "many of the matters covered [therein] * * * are also covered in [Section 8 (b) (1) (A) of the Senate bill]" H. Conf. Rep. 510, 80th Cong., 1st Sess., pp. 59, 42, I Leg. Hist. 563, 546. (See also, Bd. br. 30–31.)[2]

B. Nor is the Union's contention that Section 8 (b) (4) (C) goes as far as Congress desired, in proscribing union efforts to compel recognition, advanced by the fact that numerous proposals have been made since the passage of the 1947 amendments to outlaw minority picketing for recognition in circumstances not covered by 8 (b) (4) (C), but that these efforts have not succeeded (br. 15–18). It is commonplace that at-

[2] The foregoing analysis is not altered by the Union's reliance (br. 10) on the passage in the Conference Report which, repeating language taken from the Senate Report, states that "the primary strike for recognition (without a Board certification) was not prohibited" H. Conf. Rep. 510, 80th Cong., 1st Sess., 43, I Leg. Hist. 547; S. Rep. 105, 80th Cong., 1st Sess. 22, I Leg. Hist. 428. This statement was made in describing Section 8 (b) (4) (B), which prohibits a union, even though it may represent a majority of the employees, from inducing secondary strikes to put pressure on the primary employer to grant the recognition the union is entitled to. In this context, it was necessary to make clear that such a majority union remained free to compel recognition by striking the primary employer himself, and accordingly the reassuring statement quoted above was made.

tempts are frequently made in Congress to clarify legislation, even though such clarification may not actually change existing administrative or judicial interpretations. Accordingly, the mere fact that amendments to existing legislation have been proposed does not necessarily indicate that the power sought to be articulated does not now exist. See *Wong Yang Sung* v. *McGrath,* 339 U. S. 33, 47.

For example, several unsuccessful attempts were made subsequent to 1947 specifically to ban secondary boycotts implemented through "hot cargo" clauses—both before and after the Board had reached the conclusion that such clauses did not constitute a defense to a Section 8 (b) (4) violation. See, e. g., 100 Cong. Rec. 6121, 6125–6 (1954), 102 Cong. Rec. 8021–8022 (1956). Indeed, the recent effort in the 85th Congress to amend the Act contained not only proposals relating to minority picketing for recognition, as the Union points out (br. 15–17), but also proposals which would expressly have removed "hot cargo" clauses as a defense to secondary boycott violations under the Act. See S. 3099, 85th Cong., 2nd Sess., Sec. 3, introduced on January 23, 1958, immediately following the President's message recommending such action (reported in 41 L. R. R. M. 78, 81). These proposals respecting "hot cargo" clauses, however, did not preclude the Supreme Court from concluding that Congress had already achieved their effect by the general language contained in Section 8 (b) (4). See *Local 1976* v. *N. L. R. B.*, 357 U. S. 93. Similarly, neither should the recent proposals dealing with recognition picketing have any decisive bearing

on whether that subject is already covered by the general language of Section 8 (b) (1) (A).

C. The Union stands on no better footing in attempting to explain away the instances in the legislative debates wherein Senators Taft and Ball illustrated the meaning of Section 8 (b) (1) (A) by allusions to peaceful picketing like that involved in this case, on the ground that they later backtracked (br. 26). No disavowal of these important illustrations (see Bd. br. 25–26) ever occurred. On the contrary, when Senators Taft and Ball agreed to the deletion of the phrase "interfere with" from Section 8 (b) (1) (A), which the Union asserts reflects a "change in mood" as to the Senate's understanding of the Section's coverage (br. 26), they did so only because they did not consider that any change in meaning was thereby effected (see Bd.'s br. 29, n. 13). In sum, the examples enumerated in the legislative debates which show that the coercion proscribed by Section 8 (b) (1) (A) could result from peaceful picketing are no less important in determining the scope of that Section than are those which describe coercion by physical force.

It is also significant that the Union does not contest, as indeed it cannot, our showing (opening br. 22–24) that the central purpose of Section 8 (b) (1) (A), as revealed by its legislative history, was to impose on unions sanctions equivalent to those already imposed on employers by Section 8 (a) (1). To be sure, the Union suggests that the differences between unions and employers prevent a mechanical application of the two provisions to like situations (br. 26–27). But, al-

though this may be so in some instances (see the discussion in n. 36, p. 27, of the Union's brief), it is manifestly not so in all instances.[3] And there can be no doubt that Congress intended an even-handed application of Sections 8 (a) (1) and 8 (b) (1) (A) insofar as possible. See *Capital Service* v. *N. L. R. B.,* 204 F. 2d 848, 852 (C. A. 9). The case of minority picketing for recognition presents a most appropriate and practicable occasion to give effect to this intended principle of equivalence. For, as shown in our opening brief (p. 23) and noted *supra* (p. 3), an employer violates Section 8 (a) (1) if he accords exclusive recognition to a minority union, and there is no valid reason why a union should be under any lesser obligation to respect the right of employees freely to select their own representative.

D. The Union relies on *Electrical Workers* v. *N. L. R. B.,* 341 U. S. 694, to support its argument that Section 8 (c), which protects *noncoercive* speech (Bd. br., 37–41), immunizes its picketing in this case. In that case, as we have shown (*ibid.,* pp. 39–40), the Supreme Court limited the protection of Section 8 (c)

[3] The Union's argument is reminescent of one made by Senator Morse during the legislative debate on Section 8 (b) (1) (A). He contended that Section 8 (b) (1) (A) was unnecessary because: (1) insofar as it was intended to cover physical coercion, this matter was already subject to regulation by the local authorities; and (2) insofar as it was intended to cover economic coercion by unions, the Act's ban on closed shops adequately covered that problem and, in any event, economic threats by a union were not as "dangerous" as those by an employer because the union was not in the same position to carry out the threat. See II Leg. Hist. 1192–1193, 1195–1197. The Senate rejected these arguments in enacting Section 8 (b) (1) (A).

to "noncoercive speech * * * in furtherance of a *lawful* object." [Emphasis supplied.] 341 U. S. at 704. This limitation places Section 8 (c) to one side in the instant case, for the Union's object was concededly unlawful.

But the Union asserts that the unlawfulness of the object was not the reason why the Supreme Court declined to apply Section 8 (c) in *Electrical Workers,* which involved peaceful picketing designed to induce a secondary boycott. Rather, the Union seeks to explain the holding in that case on the ground that the Act's secondary boycott provisions, unlike Section 8 (b) (1) (A), were meant to reach peaceful picketing; accordingly, unless Section 8 (c) were found to be inapplicable to the secondary boycott provisions, they would be redundant, having a scope no greater than that of Section 8 (b) (1) (A), which admittedly applied to nonpeaceful picketing (Un. br. pp. 30–31).

Apart from the clear statements in the Supreme Court's opinion which show that the illegality of the Union's objective was a decisive consideration in finding Section 8 (c) inapplicable, the short answer to this argument is that nothing in the *Electrical Workers'* opinion warrants the Union's initial premise that the Court viewed Section 8 (b) (1) (A) as limited to nonpeaceful conduct. The fact that this Section covers nonpeaceful picketing, as the Supreme Court pointed out, may well show that other provisions of the Act meant to go beyond that coverage (see, for example, the discussion *supra,* pp. 3–5, of the interrelation between Sections 8 (b) (1) (A) and 8 (b)

(4) (C)). It does not follow, however, that the Court was thereby concluding—for indeed it had no occasion to consider such question—that nonpeaceful conduct was all that Section 8 (b) (1) (A) covered. Moreover, as this Court has recognized in *Capital Service,* peaceful picketing may impose economic coercion, and when it does, as here, Section 8 (b) (1) (A) does in fact encompass it.

E. Equating picketing with striking, the Union further argues that the protection given in Section 13 of the Act to strike conduct, "except as specifically provided for [elsewhere in the Act]," operates to save the picketing in this case from Board regulation (br. pp. 32–33). But if the Board is correct in its conclusion that the Union's picketing constituted restraint and coercion within the meaning of Section 8 (b) (1) (A), then Section 13 has no application. For Section 8 (b) (1) (A) "is a specific provision and if it is violated Section 13 is of no help." *Truck Drivers Union, Local 728* v. *N. L. R. B.,* 249 F. 2d 512, 515 (C. A. D. C.), certiorari denied, 355 U. S. 958. And it is of no consequence in this connection that Section 8 (b) (1) (A) is not expressly directed against strikes. Neither is Section 8 (b) (2), but the Union concedes (br. 53) that its picketing violated that provision, regardless of Section 13. The Union also readily admits (br. 19–28) that Section 8 (b) (1) (A) condemns violent picketing, again notwithstanding Section 13's immunizing language. The short of the matter is that the question in this case does not turn on Section 13; if the Union's picketing is coercive within the meaning of Section 8 (b) (1) (A), Section

13 can be "of no help." *Truck Drivers Union, Local 728, supra.*

II. The contention that use of the "We Do Not Patronize" list is not violative of the Act

The Union argues that, even if Section 8 (b) (1) (A) may be deemed to reach its peaceful picketing, that provision cannot reach its circulation of the "We Do Not Patronize" list, for such conduct, unlike picketing, is in no sense coercive (Un. br., 42–52). Indeed, the Union contends (br. 55) that the use of such list may not even be found to constitute a violation of Section 8 (b) (2). There is no merit to these contentions.

A. The distinction which the Union would draw between its peaceful picketing and its use of the "We Do Not Patronize" list overlooks that it is the impact of the Union's activity on Alloy and its employees which is relevant for purposes of Section 8 (b) (1) (A). That is, granted that an unfair list is less coercive than picketing insofar as inducing third parties to cease doing business with Alloy is concerned, the fact remains that both techniques are designed to achieve the same result—i. e., a curtailment of Alloy's business—and it is that which has the coercive or restraining effect on Alloy's employees that Section 8 (b) (1) (A) proscribes. Accordingly, we submit that the Board properly concluded (see Bd. opening br. 21–22, 38–39) that no distinction may be drawn, for purposes of Section 8 (b) (1) (A), between picketing and other equally effective techniques for damaging the primary employer's business.

Nor may the Union elude this conclusion by relying on Section 8 (b) (4) (B). That is, the Union notes that, in forbidding, in Section 8 (b) (4) (B), secondary boycott activity designed to obtain recognition, Congress banned only inducement of strike action by neutral employees, and did not bar unions from making appeals directly to employers and consumers (br. 43–45). The Union then assumes that, since Section 8 (b) (4) (B) leaves open such appeals, Congress would not have reached them under any other provision of the statute, and thus its appeals in this case, being directed to other employers and consumers,[4] must be lawful.

The fact that Congress in the secondary boycott provisions, including Section 8 (b) (4) (B), drew the line at strike action and did not proscribe appeals to the employers or consumers does not, as the Union assumes, necessarily determine the scope of Section 8 (b) (1) (A).[5] First, as was true with Section 8 (b) (4) (C) (see *supra*), Section 8 (b) (4) (B) was in the bill before Section 8 (b) (1) (A) was adopted, and thus the conclusion is strong that the latter was intended to enlarge upon the scope of the preexisting

[4] It may be questioned, however, whether the unfair list was not in part at least an employee appeal, rather than a pure consumer appeal, for the Union also inconsistently stresses that "it is fair to infer that * * * [the] readers [of the publication in which the 'We Do Not Patronize' list appeared] are principally workers" (br. 52).

[5] The quotations from *Local 1976* v. *N. L. R. B.*, 357 U. S. 93, relied on by the Union (br. 44, 46), discuss the problem only in the context of the secondary boycott provisions, the Court having no occasion to consider Section 8 (b) (1) (A).

provisions. Second, the secondary boycott provisions of the Act were intended to foreclose secondary activity irrespective of whether the union's ultimate demands were proper or, indeed, even if accession to them by the primary employer was required by the Act, e. g., recognition of a noncertified majority union. Thus, in leaving certain types of secondary action available to unions, the reasonable inference to be drawn is that Congress so intended only insofar as the ultimate objectives sought were themselves legitimate. See n. 2, *supra,* p. 5. Stated otherwise, it is not reasonable to infer, as does the Union, that the residual lawful area of secondary activity was meant to immunize conduct, which as we have shown with respect to the employer appeals and the "We Do Not Patronize" list here, seeks to further objectives which are clearly unlawful under the Act. Third, this Court, in *Capital Service,* has in effect already rejected the contention that consumer appeals, not covered by the secondary boycott provision, are necessarily lawful. For the secondary picketing there found to be violative of Section 8 (b) (1) (A) (at the customer entrances of the store) was deemed to be a consumer appeal, as distinguished from the delivery entrance picketing, which was an appeal to secondary employees and thus violative of Section 8 (b) (4) (A). See 204 F. 2d 848, 851–852, 854.

B. the Union's contention that its use of the "We Do Not Patronize" list and its appeals to Alloy's customers are constitutionally protected (br. pp. 47–52) is constructed on factual assumptions which are

contrary to the Board's findings in this case. Thus, the Union asserts that circulating the "We Do Not Patronize" list sought only the "performance of a lawful act" by Alloy's customers, and that in any event the "unimpeachable end" toward which the list was directed was "to inform the public that the Alloy Manufacturing Company do[es] not employ union help * * *" (Un. br. 48). The Board found, however, that the Union's appeals to Alloy's customers were not for this purpose or any of the other purposes hypothesized by the Union in its brief (pp. 48–51), but were in furtherance of the illegal goal of forcing Alloy to accord exclusive bargaining rights and a union-security agreement (R. 22, 21).[6] Accordingly, the Union's constitutional argument must be considered in the light of these findings.

So viewed, the argument boils down to the contention that the Constitution guaranteed to the Union the right to use speech[7] to induce Alloy's customers and others to boycott its products for the purpose of attaining the twin illegal objectives of exclusive recog-

[6] The quotation in the Union's brief (p. 48), to the effect that its purpose in circulating the "We Do Not Patronize" list was simply to inform the public, is taken from a self-serving letter sent by the Union to Alloy in which it denied that recognition was its objective (R. 130). The Board, of course, found to the contrary, and we do not understand that the Union means to dispute the Board's finding in this regard. See Un. br. 53; Bd's. opening br. 12–15.

[7] In this argument, the Union exempts its picketing activity, on the ground that picketing may be viewed as more than "speech," but asserts that appeals to customers and listing an employer on an unfair list are "pure speech" (Union br. 47).

nition and a union-security agreement.[8] Manifestly, the Constitution affords no such license.

As we have shown in our opening brief (pp. 37–41), speech which is designed to further illegal acts is not protected by the First Amendment. The Supreme Court made this plain in *Giboney* v. *Empire Storage & Ice Co.,* 336 U. S. 490. There, in rejecting the contention that the union's efforts to elicit an agreement which would have violated the state anti-trust laws was privileged free speech because the union merely picketed with placards advertising that the company in dispute was selling ice to non-union firms, the Court stated (*Id.,* at 502): "But placards used as an essential and inseparable part of a grave offense against an important public law cannot immunize that unlawful conduct from * * * control." See also, *Electrical Workers* v. *N. L. R. B.,* 341 U. S. 694, 704.

Nor is this principle rendered inapposite here by the Union's contention (br. 48) that, since it is "entirely legal for the customers to whom the appeal is addressed to withhold their patronage from Alloy," the "persuasion directed to them to do so seeks of them nothing but their performance of a lawful act." Even if the customers themselves could voluntarily decide to boycott Alloy, it does not follow that it would be lawful for the Union to induce such action.[9] Indeed, assuming, as the constitutional argument must, that Sec-

[8] The Union's argument drives it to conclude that even appeals in furtherance of an illegal union-shop are immune from regulation (see Union br. 53, n. 58; 54–55).

[9] E. g., although Section 8 (b) (4) (A) does not prevent neutral employees, as individuals, from quitting work, it does proscribe union inducement of such work stoppages.

tion 8 (b) (1) (A) reaches boycott appeals in furtherance of a minority union's recognition objective, the Union's requests to customers and others not to buy Alloy's products would be as illegal as union requests directed to secondary employees (which would clearly be violative of Section 8 (b) (4) (A)). Moreover, accepting the union's premise that the appeals to the customers themselves were not unlawful, the fact remains that, on the Board's findings, they were designed to force Alloy to commit illegal acts. In these circumstances, the Union utilized speech to further an unlawful course of conduct no less than if it had appealed directly to Alloy to accede to its illegal demands. In short, the Union cannot obtain constitutional protection for conduct otherwise subject to regulation merely by enlisting an intermediary to further its illegal objective.

Similarly, there is no merit to the Union's further contention (br. 51–52) that, even if its customer appeals could possibly bring about a "substantive evil," there is no showing that they would do so with "that immediacy which would justify their suppression as a clear and present danger." The Board's interpretation of Section 8 (b) (1) (A) assumes that Congress made the judgment that there was a real likelihood that the public interest would be adversely affected if labor organizations remained free to blacklist an employer and make boycott appeals to his customers for the purpose of forcing him to recognize the union contrary to the wishes of his employees. If this conclusion is not beyond reason, Congress could curb the activity without requiring an individualized showing

of "danger" in each particular case. As the Supreme Court has pointed out: "[I]nsofar as the problem is one of drawing inferences concerning the need for regulation of particular forms of conduct from conflicting evidence, this Court is in no position to substitute its judgment as to the necessity or desirability of the statute for that of Congress. * * * [E]ven restrictions on particular kinds of utterances, if enacted by a legislature after appraisal of the need, come to this Court 'encased in the armor wrought by prior legislative deliberation.'" *A. C. A.* v. *Douds,* 339 U. S. 382, 400–401.

Preserving the right of employees to be free from coercion in their selection of a bargaining representative is certainly a matter of legitimate legislative concern. See *Building Service Employees Union* v. *Gazzam,* 339 U. S. 532; *Teamsters Union* v. *Vogt,* 354 U. S. 284. Cf. *Teamsters* v. *Hanke,* 339 U. S. 470; *Giboney* v. *Empire Storage & Ice Co.,* 336 U. S. 490. Moreover, an appeal to customers to boycott the employer with whom the union has its dispute has a clear and present propensity of effecting the coercion which Congress sought to avoid no less than the employee inducements proscribed in Section 8 (b) (4). Cf. *Electrical Workers* v. *N. L. R. B.,* 341 U. S. 694, 705. Accordingly, if the clear and present danger test may be deemed applicable to the conduct here, Congress, in enacting Section 8 (b) (1) (A), satisfied that test.

III. The contention that the Board's order is too broad

Finally, the Union contends that the Board's remedial order in this case is too broad in the light of the violations found (Un. br. 55–57). The portion

of the Board's order complained of requires the Union to cease and desist from "Restraining or coercing employees of Alloy Manufacturing Company in the exercise of the rights guaranteed in Section 7 of the Act" (R. 24). The Union apparently would limit the scope of this provision to the specific picketing and customer appeals utilized by it in this case (br. 55–57). But it is settled that orders of the breadth of that in issue are proper where "the record disclose[s] persistent attempts by varying methods to interfere with the right of self-organization in circumstances from which the Board or the court found or could have found the threat of continuing and varying efforts to attain the same end in the future." *N. L. R. B.* v. *Express Publishing Co.,* 312 U. S. 426, 438; *N. L. R. B.* v. *Globe Wireless,* 193 F. 2d 748, 752 (C. A. 9); *N. L. R. B.* v. *Sunbeam Electric,* 133 F. 2d 856, 861–862 (C. A. 7); see *N. L. R. B.* v. *Jones Lumber Co.,* 245 F. 2d 388, 390 (C. A. 9). The order in this case is fully warranted under this principle. As shown in our opening brief (pp. 2–7, 13–15), the Union consistently displayed throughout the events in this case an utter disregard for the central policy of the Act that employees be guaranteed a free choice respecting matters of representation and union membership. To negate this fundamental principle, the Union sought by a variety of techniques—picketing, oral appeals to Alloy's customers, and circulation of the "We Do Not Patronize" list—to harm Alloy's business and thereby threaten the livelihood of its employees. The Board, in those circumstances, could reasonably conclude that the

Union's conduct reflected an intent to gain representation rights and a compulsory union membership agreement at any cost, and that a broad cease and desist order was therefore necessary. Cf. *McComb* v. *Jacksonville Paper Co.*, 336 U. S. 187, 192.[10]

CONCLUSION

For the foregoing reasons and those stated in the Board's opening brief, it is respectfully submitted that a decree should be entered enforcing the Board's order in full.

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OCTOBER 1958.

[10] Cases in which this Court has stricken broad cease and desist orders entered by the Board (e. g., *N. L. R. B.* v. *California Date Growers Assoc.*, decided September 29, 1958, 42 LRRM 2805; *N. L. R. B.* v. *Shuck Construction Co.*, order modified May 16, 1957, 40 LRRM 2167) have involved violations which were not prompted by the kind of flagrant opposition to the Act's policies which the record reveals in this case.

U. S. GOVERNMENT PRINTING OFFICE: 1958

No. 15,814

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD, *Petitioner*

v.

INTERNATIONAL ASSOCIATION OF MACHINISTS, LODGE 942, AFL-CIO, *Respondent*

On Petition For Enforcement of an Order of The National Labor Relations Board

---

PETITION FOR REHEARING

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PETITION FOR REHEARING

Respondent prays that a rehearing be granted of that part of the Court's decision which declines to consider on the merits the question whether picketing to obtain the recognition of a union as the exclusive bargaining representative at a time when it does not have a majority constitutes a violation of Section 8(b)(1)(A) of the National Labor Relations Act.

1. Declination to consider the merits is based on Section 10(e) of the Act: "No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to

urge such objection shall be excused because of extraordinary circumstances." Neither in its statement of points (R. 139), its brief, or on oral argument did the Board suggest that Section 10(e) applied to preclude consideration of the merits of the naked question of law presented. On the contrary, the Board in its brief carefully differentiated between (1) the question of the substantiality of the evidence to support the findings of fact and (2) the question of law presented based upon acceptance of the findings. As to the findings of fact only did the Board urge that in the absence of exceptions these "are not subject to contest before this Court" (Bd. br. p. 13). Upon the question of law the Board in its brief addressed itself entirely to the merits and at no point intimated that the merits were not properly before the Court (Bd. br. pp. 15-41). Since respondent did not contest the findings of fact, and since the applicability of Section 10(e) to the question of law had not been put in issue, respondent did not treat with it. The Court thus *sua sponte* based decision on a point which, if available to the Board at all, had been waived by it. "This point was not argued by appellant, in its brief or orally, and hence is deemed abandoned." *Western Nat. Ins. Co.* v. *Le Clare,* 163 F. 2d 337, 340 (C.A. 9), and cases cited. And since Section 10(e) is not "a limitation on jurisdiction" but rather "a mandate to be observed by the reviewing court in the exercise of its admitted jurisdiction" (*Phillips* v. *S.E.C.,* 156 F. 2d 606, 608 (C.A. 2), cf. *Smith* v. *Apple,* 264 U. S. 274, 277-280), the Court is not obliged to animate an issue which has not been tendered. We suggest that as a matter of judicial administration it would seem to be at least as salutary for a court not to consider an objection not urged before it as to decline to consider the merits of a naked question of law because of the absence of exceptions before the agency.

2. The Board did not urge that the absence of exceptions foreclosed consideration of the merits of the question of law, not because of want of astuteness to make a valid

point, but because Section 10(e) has no application to this issue in the circumstances of this case. For the short of the matter is that the Board did not rely upon the lack of exceptions but considered and decided the question on its merits. The Board stated that (R. 19):

> The Trial Examiner found that by its conduct in picketing the premises of the Alloy Manufacturing Company with an object of obtaining exclusive recognition at a time when it did not represent a majority of Alloy's employees, the Respondent Union violated Section 8(b)(1)(A) of the Statute. No exceptions have been filed to this conclusion. The Trial Examiner's findings of fact, preliminary to his conclusion of law, are amply supported by the record. Moreover, his conclusion comports with our decision in Curtis Brothers, 119 NLRB No. 33. Accordingly we find, as did the Trial Examiner, that the Respondent violated Section 8(b)(1)(A) by picketing Alloy for exclusive recognition when it represented no more than a minority of employees.[2]

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2 Member Jenkins who concurred specially in the Curtis decision limited his concurrence therein to the unlawful picketing after a decertification election—which he believed to be the issue raised by the complaint in Curtis. As the complaint in the instant case is broader in that it covers all picketing for an illegal objective regardless of whether there has been an election, he therefore subscribes fully to the opinion herein.

Thus the Board did not state that it was adopting the examiner's conclusion in the absence of exceptions to it; rather it stated that it was independently finding as he did on the authority of its own contemporaneous decision in *Curtis*. Member Murdock in dissent noted that the absence of exceptions was a means of disposing of the issue without reaching the merits and remonstrated the majority for not following that course (R. 27-28):

> Inasmuch as no exceptions were filed to the Trial Examiner's findings with respect to the 8(b)(2) and 8(b)(1)(A) violation or to his failure to find an 8(b)(1)(A) violation on the basis of picketing for a union shop, I see no reason to pass upon these issues. How-

> ever, as the majority's 8(b)(1)(A) findings are based upon the theory of coercion adopted in the Curtis case, that peaceful picketing for recognition by a union constitutes coercion under Section 8(b)(1)(A), I do not agree with the rationale of the findings.

And, while the Board denied the request for oral argument in this case (R. 18, n. 1), the Board heard oral argument in *Curtis* and in *Shepherd Machinery Co.*, 19 NLRB No. 39, 41 LRRM 1065, simultaneously (Bd. br. p. 49, n. 1, 61, n. 11), and it issued its decision in *Shepherd* and in this case on the same day, giving this case the earlier number and disposing of an issue in *Shepherd* by citation of this case (41 LRRM 1065, n. 2).

It is thus patent that the Board deliberately disregarded the absence of exceptions and instead chose to utilize this case and *Curtis* as its vehicles for the full expression of its pioneer interpretation of Section 8(b)(1)(A). It is not unusual for the Board to consider the merits of a matter although no exceptions are directed to it. Under its rules, although it need not, it may consider a particular issue to which no exception is taken if the case is before it on any exceptions.[1] It not infrequently does so.[2] It did so here designedly and with full foreknowledge.

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[1] Section 102.48(a) of the Board's rules provides that:

> In the event *no* statement of exceptions is filed as herein provided, the findings, conclusions, and recommendations of the trial examiner as contained in his intermediate report and recommended order *shall* be adopted by the Board and become its findings, conclusions, and order, and *all* objections and exceptions thereto *shall be deemed waived* for *all* purposes [emphasis supplied].

On the other hand Section 102.48(b) provides that:

> Upon the filing of a statement of exceptions and briefs, as provided in section 102.46, the Board *may* decide the matter forthwith upon the record, or after oral argument, or *may* reopen the record and receive further evidence before a member of the Board or other Board agent or agency, or *may* close the case upon compliance with recommendations of

In these circumstances there is no room for the application of Section 10(e). Section 10(e) expresses "the salutary policy . . . of affording the Board opportunity to consider on the merits questions to be urged upon review of its order." *Marshall Field and Co.* v. *N.L.R.B.,* 318 U.S. 253, 256; *N.L.R.B.* v. *Cheney California Lumber Co.,* 327 U.S. 385, 389. When the Board, despite the absence of exceptions, does consider on the merits the question thereafter urged on review, the reason for the rule disappears. The Board can claim neither that it was deprived of an administrative "opportunity for correction" (*United States* v. *L.A. Tucker Truck Lines,* 344 U.S. 33, 37), nor that it was not "put . . . on notice of the issue now presented" (*May Department Stores Co.* v. *N.L.R.B.,* 326 U.S. 376, 386, n. 5).

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the intermediate report, *or may make other disposition of the case* [emphasis supplied].

Section 101.12(a) of the Board's Statements of Procedure explains in part that:

> If *any* party files exceptions to the intermediate report, the Board, with the assistance of the legal assistants to each Board member who function in much the same manner as law clerks do for judges, *reviews the entire record,* including the trial examiner's report and recommendations, the exceptions thereto, the complete transcript of evidence, and the exhibits, briefs, and arguments. * * * It then issues its decision and order in which it may adopt, modify, or reject the findings and recommendations of the trial examiner [emphasis supplied].

On the other hand Section 101.12(b) explains that:

> If *no* exceptions are filed to the intermediate report, and the respondent does not comply with its recommendations, the Board adopts the report and recommendations of the trial examiner. All objections and exceptions, whether or not previously made during or after the hearing, are deemed waived for all purposes [emphasis supplied].

[2] *E.g., International Brotherhood of Teamsters, Local 179,* 110 NLRB 287, 288; *Utah Construction Co.,* 95 NLRB 196, 211, n. 38; *General Shoe Corp.,* 90 NLRB 1330, 1333, n. 12; *International Rice Milling Co. Inc.,* 84 NLRB 360 (wherein the Board dismissed a complaint although no exceptions were taken to the examiner's findings of violations and the only exceptions taken were by proponents of the complaint who contended that the examiner had not gone far enough. For a further history of this case see, 183 F. 2d 21 (C.A. 5), reversed in part, 341 U. S. 665).

The Board deliberately sought out the issue and considered its merits as fully as it would have had specific exception been taken. To apply Section 10(e) nonetheless would be an anachronistic exaltation of form. Accordingly, as the Court of Appeals for the Second Circuit said of Section 24(a) of the Public Utility Holding Company Act,[3] a provision like Section 10(e), "It seems not inappropriate for us to consider the lack of objection here as excused because of the Commission's own actions in examining the issue involved and to decide the case upon the merits. . . ." *Phillips* v. *S.E.C.*, 156 F. 2d 606, 608. And as the Court of Appeals for the District of Columbia Circuit has similarly stated, "Section 19(b) of the Natural Gas Act limits our consideration to those points which have been urged before the Commission in an application for rehearing. The plain purpose of that provision of the statute is to give the Commission an opportunity to rule upon any matter which is to be relied upon on review. The Commission is thus placed in the position of framing the issues we shall hear. By waiving a procedural irregularity and deciding the underlying substantive issue, the Commission places that substantive issue before us for review." *City of Pittsburgh* v. *F.P.C.*, 237 F. 2d 741, 749. So here, by disregarding the absence of exceptions and deciding the underlying substantive issue, the Board places that substantive issue before the Court for review. The Board does not contend otherwise.

3. There is an inherent limitation upon the applicability of Section 10(e) which is pertinent here. The absence of objection does not foreclose judicial inquiry to determine whether the Board has "traveled outside the orbit of its authority. . . ." *N.L.R.B.* v. *Cheney California Lumber Co.*, 327 U.S. 385, 388. The obligation of judicial oversight to this extent has been recognized by this Court even where

[3] "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure to do so."

no exceptions to the examiner's report have been filed by any party to the proceeding. *N.L.R.B.* v. *Red Spot Electric Co.*, 191 F. 2d 697. As Judge Pope stated in his concurring opinion in that case, "upon a petition of this kind we should carefully examine the record for the purpose of determining that the Board had jurisdiction to make its order and that it has not 'traveled outside the orbit of its authority.' Such procedure is in conformity with the ancient practice of courts of equity when asked to enter a default decree." *Id.* at 699-700.

The issue in this case is squarely within this reservation. It presents the naked question of law whether the Board acts in excess of its statutory authority when it requires the cessation of picketing to secure the recognition of a union which does not have majority status. To the solution of this question agency expertness does not contribute. Even if it did, the Board has expressed its full thoughts on the subject. And this is not the distinct situation where the power of the agency to lay its hand upon the subject is admitted and the only question is whether the circumstances exist which renders exertion of the power permissible. If respondent is correct in its view of the reach of Section 8(b)(1)(A) the decree would prohibit it from engaging in conduct which is allowable to all others under the law of the land.

4. Section 10(e) is not so exigent as to require or permit this Court *sua sponte* to decline to reach the merits of a naked question of law which the Board did affirmatively consider and decide and which goes to the Board's statutory authority. As the Supreme Court stated in *Hormel* v. *Helvering*, 312 U.S. 552, in holding that a Court of Appeals "should have given and properly did give consideration" to a point not presented to or considered by the Board of Tax Appeals (*id.* at 559), as ingrained a part of the rule that "Ordinarily an appellate court does not give consideration to issues not raised below" (*id.* at 556) is the qualification "that such appellate practice should not be

applied where the obvious result would be a plain miscarriage of justice" (*id.* at 558). To heed the qualification is not to disrespect the rule (*id.* at 557):

> Rules of practice and procedure are devised to promote the ends of justice, not to defeat them. A rigid and undeviating judicially declared practice under which courts of review would invariably and under all circumstances decline to consider all questions which had not previously been specifically urged would be out of harmony with this policy. Orderly rules of procedure do not require sacrifice of the rules of fundamental justice.

The *Hormel* teaching is particularly pertinent here. For here the Board *did* consider and decide the merits of the issue which the Court is asked to review, here the issue pertains to "agency action taken in excess of delegated powers" (*Leedom* v. *Kyne,* 3 L. ed. 210, 215), and here no objection has been interposed to judicial review of the merits of the issue. To read Section 10(e) as nevertheless precluding judicial review is to disregard its purpose and the tradition of appellate practice of which it is a part.

Wherefore this petition for rehearing should be granted and the Court should proceed to consider the merits of the question whether Section 8(b)(1)(A) of the National Labor Relations Act prohibits picketing by a union to secure its recognition as the exclusive representative at a time when it does not have a majority.

Respectfully submitted,

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February 1959.

Certificate of Counsel

I certify that this petition for rehearing is not interposed for delay and in my judgment it is well founded.

BERNARD DUNAU
Attorney for Respondent.

February 1959.

No. 15821

United States Court of Appeals

For the Ninth Circuit

JOHN R. HANSEN and SHIRLEY G. HANSEN, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR PETITIONERS

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PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR PETITIONERS

STATEMENT OF JURISDICTION

This is a petition to review a decision of the Tax Court of the United States. The United States Court of Appeals has exclusive jurisdiction, by Section 7482 (a) of the Internal Revenue Code.

Venue for review by the United States Court of Appeals for the Ninth Circuit, is based upon Section 7482 (b) (1) of the Internal Revenue Code. The returns of Tax in respect to which the controversy arises, were made to the office of the Internal Revenue Service in Tacoma, Washington, within the Ninth Circuit (R. 5).

Jurisdiction of the Tax Court of the United States was based on Section 6213 (a) of the Internal Revenue Code. Timely petition for redetermination of the deficiency was filed with the Tax Court (R. 6).

STATEMENT OF THE CASE

Petitioners are John R. Hansen and Shirley G. Hansen, husband and wife. Mr. Hansen was doing business as an automobile dealer in the years at issue. Respondent determined that there were deficiencies in income tax for the petitioners for the calendar years 1951, 1952 and 1953, and penalties for the same years. After exhaustion of the procedure for administrative review, Notice of Deficiency was mailed on January 27, 1956. Petitioners filed Petition for Redetermination of Deficiency with the Tax Court of the United States, on April 26, 1956. Amended Petition was filed by stipulation.

Petitioners disputed all alleged deficiencies resulting from the allocation to income of a contingent liability reserve withheld from Petitioners by General Motors Acceptance Corporation. Petitioners further disputed penalties imposed for failure to file declaration of estimated tax, under section 294(d)(1)(A) of the Internal Revenue Code (1939), and for substantial underestimation of declaration of estimated tax, under section 294(d)(2) of the Internal Revenue Code (1939).

The Tax Court of the United States entered decision in favor of the Commissioner of Internal Revenue, respondent herein, on August 1, 1957. Petition for Review by the United States Court of Appeals for the Ninth Circuit, was filed by registered mail with the Tax Court, pursuant to Rule 29, on October 31, 1957.

The taxes and penalties in controversy are:

		Penalties, I.R.C. of 1939	
		Section	Section
Taxable Year	Income Tax	294(d)(1)(A)	294(d)(2)
1951	$1,092.66	$847.66	$565.10
1952	686.40	563.51	375.67
1953	3,221.46	532.64	355.10

Upon this appeal petitioners are not disputing the penalties imposed for failure to file declarations of estimated tax, under section 294(d)(1)(A) I. R. C. (1939); excepting insofar as such penalties were based upon the erroneous allocation of contingent liability reserve to income.

Petitioners made payments to respondent in lieu of bond pending this appeal, of $4,750.00 on January 15, 1958, and of $4,840.39 on January 23, 1958, without waiver of the questions involved in this appeal.

QUESTIONS INVOLVED

(1) Did finance fees withheld by General Motors Acceptance Corporation in a contingent liability reserve, accrue as income to auto-dealer petitioners in the year when the reserves were created by G.M.A.C., or alternatively, in the year when released to petitioners, if ever released at all? This is the main issue.

(2) Does petitioners' failure to file declarations of estimated tax in 1951, 1952 and 1953, incur the distinct penalty for substantial underestimation of declaration of estimated tax, under I. R. C. (1939) Sec. 294(d)(2); where no estimated returns at all were filed and where the explicit pen-

alty for failure to file was imposed under I. R. C. (1939) Sec. 294(d)(1)(A)?

STATEMENT OF THE FACTS

1. Petitioners are husband and wife, residing in a community-property state, where the husband is a Buick dealer engaged in the business of selling automobiles at retail (Alleged, R. 10; Admitted, R. 26).

2. Petitioners sell new autos upon conditional sales contracts (Admitted, R. 26).

3. All of petitioners' sales on credit in the tax years at issue were made upon the same G.M.A.C. form of conditional sales contract, Joint Exhibit 5-E, and all were financed by General Motors Acceptance Corporation (Stipulated, R. 6).

4. The conditional sales contracts were payable by the retail purchaser at the office of General Motors Acceptance Corporation (Joint Exhibit 5-E, (8), at R. 39).

5. Petitioners in fact held none of the conditional sales contracts for financing by petitioners, and financed none of them through any finance company other than G.M.A.C. (Stipulated, R. 6; R. 29).

6. The course of dealing between petitioners and G.M.A.C. required that a contingent liability reserve, called "Dealer's Reserve," be withheld by G.M.A.C. out of the finance charges (R. 30, 31, 35, 36).

7. The pattern of petitioners' financing of credit sales was a single transaction: The retail purchaser signed the conditional sales contract on the same form;

petitioners assigned the contract to G.M.A.C. by the same form for assignment on the face of the contract, and delivered it to G.M.A.C. in return for money (R. 6, 35; Joint Exhibit 5-E at R. 39).

8. The amounts of the contingent liability reserve was set at five per cent of the total amount of conditional sales contracts outstanding with G.M.A.C. for petitioners' customers (R. 31).

9. The purpose of the reserve was to protect G.M.A.C. from losses. Losses from prepayment by auto purchasers and losses from abnormal depreciation before repossessions were chargeable to the reserve (R. 31).

10. The reserve was withheld and controlled completely by G.M.A.C. (R. 32).

11. Petitioners could not draw upon the contingent liability reserve at will; could not borrow against it; and had no right to any of the reserve until release by G.M.A.C. (R. 32, 38).

12. Release of any reserve was contingent upon there being in the reserve an excess over five per cent of outstanding contracts (R. 31).

13. Loss chargeable to contingent liability reserve did occur, due to prepayments and due to abnormal depreciations before repossession (R. 31).

14. Petitioners withdrew funds released to them when they could get them, and took all they could get (R. 33).

15. All payments actually received by petitioners from G.M.A.C., including funds released from contin-

gent liability reserve, were reported as income in the years in which received (R. 33, 36, 37).

16. Losses already charged by G.M.A.C. against the contingent liability reserve were not written off by petitioners as bad debts. Petitioners' bad debts account had nothing to do with the sale of autos on credit (R. 32, 37).

17. Petitioners' accounts followed a regular and consistent theory of accounting in 1951, 1952 and 1953, excepting only that all contingent liability reserves created by G.M.A.C. in 1952 were picked up as income in 1952 (R. 35).

18. Petitioners' accounting was upon the accrual basis (R. 36).

SPECIFICATION OF ERRORS

(1) The Tax Court erred in holding that finance fees withheld by General Motors Acceptance Corporation in a contingent liability reserve, accrued as income to auto-dealer petitioners in the year in which the reserves were created by G.M.A.C., rather than in the year in which released to petitioners, if ever released at all (R. 65).

(2) The Tax Court erred in sustaining penalties imposed for substantial underestimation of declaration of estimated tax, under I. R. C. (1939) Sec. 294(d)(2), where no estimated returns at all were filed and where the explicit penalties for failures to file were imposed under I. R. C. (1939) Sec. 294 (d)(1)(A) (R. 67, 68).

(3) The Tax Court erred in sustaining penalties where

the penalties were based upon amounts erroneously held to be income; both as to penalties imposed for failure to file declarations of estimated tax, under I. R. C. (1939) Sec. 294(d)(1)(A), and as to penalties imposed for substantial underestimation, under I. R. C. (1939) Sec. 294(d)(2) (R. 70).

(4) The foregoing errors render erroneous the entry of decision wherein the Tax Court ordered and decided that there are deficiencies for the taxable years of 1951, 1952 and 1953, totalling $8,240.20 (R. 70).

PETITIONERS' ARGUMENT

I.

FINANCE FEES WITHHELD IN CONTINGENT LIABILITY RESERVE BY G.M.A.C. ACCRUED AS INCOME TO AUTO-DEALER PETITIONERS IN THE YEAR WHEN RELEASED TO PETITIONERS, AND NOT IN THE YEAR WHEN CREATED AS RESERVE BY G.M.A.C.

A. NONE OF THE FUNDS IN ISSUE WERE RELEASED TO PETITIONERS IN THE TAX YEARS INVOLVED

The only funds in issue here are those withheld by G.M.A.C. in its contingent liability reserve, and not released to petitioners in the tax years. Where there was an excess of reserve over 5 per cent of outstanding contracts financed for petitioners, the excess was released by G.M.A.C. annually. Petitioners withdrew funds released to them when they could get them, and took all they could get. Petitioners have declared every such payment received.

B. EACH SALE OF AN AUTO ON CREDIT WAS A SINGLE THREE-PARTY TRANSACTION, TO WHICH G.M.A.C. WAS A NECESSARY PARTY

In substance the sale of an auto on credit was and had to be a single three-party transaction. Petitioners sold an auto, for trade-in and cash. G.M.A.C. sold the use of its money, for a finance charge. The purchaser bought both—the auto from the dealer, and the credit from the finance company. The finance charge was G.M.A.C.'s price for the use of its money, and was gross income to G.M.A.C., not to petitioners.

There had to be a finance company in each transaction, because the purchaser was unable to pay cash for the car. G.M.A.C. was a necessary party to every sale of an auto on credit. The absence of contractual requirement to finance sales through G.M.A.C. is immaterial, where practical business necessity caused every credit sale to be so financed.

Petitioners used the same finance company to finance every credit sale during the three tax years in issue, without exception. They used the same conditional sales contract and assignment form. As the United States Court of Appeals, Fourth Circuit, said in *Blaine Johnson v. Commissioner* (1956) 233 F.2d 952, at 957:

> "The pattern of each sale was a single transaction from the time the trailer was sold through the time the note was discounted by the particular finance company on whose forms it was executed."

The Sixth Circuit has said:

> "And without regard to whether the result is imposition or relief from taxation, the courts have recognized that where the essential nature of a

transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority." *Commissioner v. Ashland Oil & Refining Co.,* 99 F.2d 588, 591, cert. denied 4-17-39.

In *Helvering v. New Haven & Shore Line Ry. Co., Inc.,* 121 F.2d 985, 988, cert. denied 2-9-42, the Second Circuit said:

> "As for the effort of the Commissioner to atomize the plan, as it were, *i.e.,* to separate it into its several steps and treat the last as though it stood alone, it has been repeatedly repudiated."

C. PETITIONERS HAD NO ACTUAL RECEIPT OF THE FUNDS IN ISSUE, AS INCOME

Petitioners had no actual receipt of the funds in issue, as income. Each conditional sales contract provided for the time payments to be made at the office of G.M.A.C. No time payments were made to petitioners. Each contract was assigned by petitioners to G.M.A.C. upon execution. The consideration paid to petitioners by G.M.A.C. was taken up and declared by petitioners as income, and is not in issue.

D. PETITIONERS HAD NO CONSTRUCTIVE RECEIPT OF THE FUNDS IN ISSUE, AS INCOME

Petitioners had no constructive receipt of the funds in issue, as income. Regulation 118, §39.42-2, sets forth the doctrine of constructive receipt. It provides that income may be taxed prior to the year of actual receipt although not then actually reduced to possession, if: (1) it is credited to the account of or set apart

for the taxpayer, and (2) it may be drawn upon by the taxpayer at any time.

> "To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition * * * " Reg. 118, §39.42-2.

The plain fact is that the reserve withheld by G.M.A.C. could not be "drawn upon by petitioners at any time." There could be no payment to petitioners at all unless the reserve exceeded 5 per cent of total outstanding contracts financed for petitioners; and then payment was limited to the excess, without invasion of the 5 per cent reserved which the Commissioner has allocated to income.

There were substantial, concrete, restrictive conditions precedent. Any payment to petitioners was contingent upon an excess, which could result only if G.M.A.C. had favorable experience in collections upon the contracts from customers of petitioners. Favorable experience was uncertain, because losses from prepayments by auto purchasers were chargeable to the reserve, as were losses for abnormal depreciation before repossession. The testimony establishes that there always were such losses. Because of losses to be charged to the reserve, the ultimate receipts from it by petitioners were not determinable at the dates of creation of reserve.

G.M.A.C. retained control of the contingent liability

reserve. Petitioners had no enforceable right to the funds in issue. Neither bankruptcy nor starvation would have given petitioners a legal right to reach the reserve. It was a true reserve, with specific conditions precedent and definite contingencies, in the control of a party dealing at arm's length with petitioners.

E. THE U. S. COURT OF APPEALS FOR THE SIXTH CIRCUIT DECIDED A SIMILAR ISSUE IN FAVOR OF A TAXPAYER, IN 1932

In the case of *Commissioner v. Cleveland Trinity Paving Co.* (1932) 62 F.2d 85, the Court of Appeals for the Sixth Circuit reached the same result, in principle. It held that, under a paving contract, percentages retained to guarantee maintenance of pavement were taxable as income to the contractor in the years when the money was paid, rather than in the years when the contracts were completed except as to maintenance. The court noted "the further principle that the fact that the taxpayer kept its books in most respects upon the accrual basis does not require it to accrue that which is but contingently earned." *Commissioner v. Cleveland Trinity Paving Co.* (1932) 62 F.2d 85. The Commissioner did not appeal.

F. THE U. S. COURT OF APPEALS FOR THE THIRD CIRCUIT DECIDED THE PRESENT ISSUE IN FAVOR OF A TAXPAYER, IN 1944

The United States Court of Appeals for the Third Circuit decided the present issue in 1944, in *Keasbey & Mattison Co. v. United States*, 141 F.2d 163. The taxpayer was a manufacturer of asbestos products who

arranged with a finance company to discount notes given by purchasers to retailers of its products. Under its contract with the finance company the taxpayer guaranteed part of the notes. Part of the discount was to be retained by the finance company in a reserve account analogous to G.M.A.C.'s reserve, to cover the guaranty. Circuit Judges Biggs, Jones and Goodrich unanimously held that the amount of the reserve was not income to the taxpayer so long as the right to any of it was uncertain. The *Keasbey & Mattison* case involves the same principles as the *Hansen* case, and is directly in point. The United States did not appeal.

G. THE U. S. COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED THE PRESENT ISSUE IN FAVOR OF A TAXPAYER, IN 1956

The United States Court of Appeals for the Fourth Circuit decided the present issue in *Blaine Johnson v. Commissioner* (1956) 233 F.2d 952. The taxpayers were dealers in trailers, who financed credit sales by endorsing purchasers' promissory notes over to banks and to a finance company. A variable reserve was withheld from the taxpayers by the bank or finance company.

The court held that the reserves withheld were not taxable income to the taxpayer in the years in which credited as reserves, but rather in the years in which they became payable to taxpayers.

The court said:

> "The general principles which must control our decision have been authoritatively stated by the Supreme Court. It is 'the right to receive and not

the actual receipt' of an amount which determines its accruability. 'When the right to receive an amount becomes fixed, the right accrues.' *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182, 184, 185, 54 S.Ct. 644, 645, 78 L.Ed. 1200. Until the right to an amount becomes accruable through fixation of the right to receive, the taxpayer is under no obligation to return it as income. Otherwise he would be required to pay a tax on income which he might never have a right to receive. *North American Oil Consolidated v. Burnet,* 286 U.S. 417; 423-424, 52 S.Ct. 613, 76 L.Ed. 1197." *Blaine Johnson v. Commissioner* (1956) 233 F.2d 952, at 956.

The Fourth Circuit reaffirmed the principles stated in the *Blaine Johnson* case, *supra,* in *Long Poultry Farms, Inc. v. Commissioner* (1957) 249 F.2d 726. A patronage refund credit alloted to the taxpayer by an agricultural cooperative association had been retained by the association as a reserve. The credit in reserve was held not includible as income to the taxpayer because it was "a contingent credit."

H. THE U. S. COURT OF APPEALS FOR THE FIFTH CIRCUIT HAS DECIDED THE PRESENT ISSUE IN FAVOR OF TAXPAYERS IN TWO CASES, IN 1958

The Tax Court holding again was reversed, in *Texas Trailercoach, Inc. v. Commissioner* (1958) — F.2d —, 1 A.F.T.R.2d 58-533, reversing 27 T.C. 575. The taxpayer was a dealer in trailers from whom amounts had been withheld in dealers reserve, by a finance company. The Fifth Circuit held that the amounts in reserve were not income to the dealer until there was a fixed

right to receive them, under the terms of the agreement between dealer and finance company.

The court pointed out in the *Texas Trailercoach* case that tax incidence should reflect the realities of a business transaction, *Ibid.,* 1 A.F.T.R.2d 58-533, -534; that the sale on credit was "one transaction—a three-cornered agreement with interrelated obligations of dealer, purchaser, and finance company." *Ibid.,* 1 A.F.T.R.2d 58-533, -535; and that "from a lay or purely practical point of view, the five per cent did not become fixed or ascertainable and therefore accrue in the taxable year in question." *Ibid.,* 1 A.F.T.R.2d 58-533, -535. The basic principles controlling accrual were reviewed in part IV of the decision.

Circuit Judge Wisdom said:

> "The real trouble in this case is that the taxpayer is asked to pay a tax on money he did not in fact receive and had no right to receive during the taxable year in question. He may never receive it, but he is asked to deplete his cash in order to pay it. If compelled to pay, the more business he does —the worse off his cash position will be. But, if a more realistic view is taken, the Government will not be deprived of any tax, because when the contingent credit materializes as a fixed, ascertainable claim or if payments are received from the reserve account, the taxpayer must then include the fixed claim or payments in his taxable income." *Texas Trailercoach, Inc. v. Commissioner* (5 Cir. 1958) — F.2d —, 1 A.F.T.R.2d 58-533, 541.

Petitioners submit that the *Texas Trailercoach* decision, *supra,* fits the present case in that the sale on credit was one three-cornered transaction, the reserve

to be received was not fixed or ascertainable in the tax year, and in that there was no actual receipt or right to receive in the tax year in question.

West Pontiac, Inc. v. Commissioner (5 Cir. 1958) — F.2d —, 1 A.F.T.R.2d 58-451, reversing 25 T.C. 749, was a dealers reserve case in which the taxpayer was a General Motors dealer, financing with G.M.A.C. After the *Texas Trailercoach* decision, *supra,* West Pontiac moved for judgment. The Commissioner by letter appeared to the court to agree that the issue was essentially the same as in *Texas Trailercoach, supra.* Judgment was entered in favor of the taxpayer, without briefing and oral argument.

District Courts have held that dealers' reserve withheld did not accrue as income, in *Massey Motors, Inc. v. United States* (S.D. Fla. 1957), 156 F.Supp. 516; *Hines Pontiac v. United States* (N.D. Texas 1957), — F.Supp. —, 1 A.F.T.R.2d 58-734, and in *Modern Olds, Inc. v. United States* (N.D. Texas 1957), — F. Supp. —, 1 A.F.T.R.2d 58-732.

I. APPELLATE AUTHORITY SHOULD BE UPHELD

> "The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court * * *; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari * * *." I.R.C. (1954) sec. 7482 (a).

The Courts of Appeals have in each instance upheld the taxpayer upon the dealer's reserve issue. *Keasbey & Mattison Co. v. United States* (3 Cir. 1944) 141 F.2d

163; *Blaine Johnson v. Commissioner* (4 Cir. 1956) 233 F.2d 952; *Texas Trailercoach, Inc. v. Commissioner* (5 Cir. 1958), — F.2d —, 1 A.F.T.R.2d 58-533; *West Pontiac, Inc., v. Commissioner* (5 Cir. 1958) — F.2d —, 1A.F.T.R.2d 58-451.

The Commissioner has declined to follow the rule of the Courts of Appeals, Rev. Rul. 57-2, Int. Rev. Bulletin 1957-1, P-H 1957 par. 76,301. The Tax Court has declined to follow the rule of the Courts of Appeals. *Blaine Johnson,* 25 T.C. 123; *Albert M. Brodsky,* 27 T.C. 216; *West Pontiac, Inc.,* 27 T.C. 749; *Texas Trailercoach, Inc. v. Commissioner,* 27 T.C. 575; *Burl P. Glover,* par. 57,045 P-H Memo T.C.; *J. H. Schaeffer, Jr., et al.,* par. 57,068 P-H Memo T.C.; *John R. Hansen, et al.,* par. 57,113 P-H Memo T.C.

This situation works injustice, because only the taxpayer who can pay the expense of appeal can prevail, and he only at considerable expense. As each additional Circuit rules against the Commissioner, his position should become more awkward. Petitioners submit that the appellate authority should be upheld.

II.

FAILURE TO FILE DECLARATIONS OF ESTIMATED TAX IN 1951, 1952 AND 1953, DOES NOT INCUR THE DISTINCT PENALTY FOR SUBSTANTIAL UNDERESTIMATION OF DECLARATIONS

A. FAILURE TO FILE AN ESTIMATION IS NOT UNDERESTIMATION

Congress imposed only a single civil penalty for failure to file declarations without reasonable cause. There

are two separate and distinct penalties in the Code, one of 6 per cent for substantial underestimate, and the other of 10 per cent for failure to estimate at all. If Congress intended a 16 per cent penalty for failure to file, Congress would have made it 16 per cent.

I.R.C. (1939) sec. 294 (d) provides:

> "(1) Failure to File Declaration or Pay Installment of Estimated Tax.—(A) Failure to file declaration.—In the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month (except the first) or fraction thereof during which such amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10 per centum of the unpaid portion of such installment.* * *."
>
> "(2) Substantial Underestimate of Estimated Tax.— If 80 per centum of the tax * * * exceeds the estimated tax * * * there shall be added to the tax an amount equal to such excess, or equal to 6 per centum of the amount by which such tax so determined exceeds the estimated tax so increased, whichever is the lesser * * *."

The legislative intent to impose only a single penalty for failure to file was demonstrated in the Internal Revenue Code of 1954. The separate penalty for failure to file declarations of estimated tax was removed, I.R.C.

(1954) sec. 6651 (c); and a single penalty of 6 per cent per annum was imposed for failure to pay estimated tax, whether declaration was filed or not. I.R.C. (1954) sec. 6654.

B. FIVE DISTRICT COURTS HAVE DETERMINED THIS ISSUE IN FAVOR OF TAXPAYERS

The U.S. District Court for the Northern District of Georgia decided this point in 1954 in the case of *United States v. Ridley,* 120 F.Supp. 530, at page 538:

> "The addition of 10% of the tax for failure to file the declaration or to pay the installment of the estimated tax is proper to be added in the appropriate years. However, the addition of 6% for substantial underestimate of estimated tax is improper for the very obvious reason that the tax was not underestimated, indeed, the taxpayer filed no declaration of estimated tax at all and suffers the greater sanction of 10% addition to the tax for the failure, and the failure to pay the tax.
>
> "The argument of the government that the failure to file the declaration of estimated tax is in effect a declaration of no tax, thus subjecting the taxpayer to this penalty, is rejected as contrary to a proper construction of the statutes."

The *Ridley* decision has not been appealed. It was followed in *Powell v. Granquist* (D.C. Oregon 1956), 146 F.Supp. 308.

Owen v. United States (D.C. Nebr. 1955), 134 F. Supp. 31, supports petitioners' position. Taxpayer was held not subject to penalty for substantial underestimate, although he was subject to penalty for failure to file. Appeal was dismissed on stipulation of parties. *United States v. Owen* (8 Cir. 1956) 232 F.2d 894.

In *Stenzel v. United States* (D.C. N.D. Cal. 1957), 150 F.Supp. 364, the sole issue was whether the government could collect the 6% penalty for underestimation in addition to the 10% penalty for failure to file. In holding for the taxpayer, District Judge Harris said:

> "There is nothing in the history of the Revenue Act of 1943 which shows that in rewriting Section 294 (d) (2), Congress intended that, in the event of the failure to file the required declaration the amount of the estimated tax would be zero. The construction contended for by the government is inconsistent with the plain congressional intention. It attempts, inferentially, to dignify a Bureau regulation giving it the same force and effect as congressional enactment. The cumulative penalties sought to be imposed are in conflict with any fair, reasonable and just statutory construction." *Stenzel v. United States* (D.C. N.D. California 1957), 150 F.Supp. 364, at 365.

In *Jones v. Wood* (D.C. Ariz. 1957), 151 F.Supp. 678, 680, Chief Judge Ling said:

> "The penalty for substantial underestimation of tax cannot lawfully be imposed unless an estimate of tax has been filed.* * * The imposition is improper for the very obvious reason that the tax was not underestimated. Indeed there was no estimate filed at all."

Farrow v. United States (D.C. S.D. Cal. 1957), 150 F.Supp. 581, is contra.

As a matter of law, petitioners submit that the penalty for substantial underestimation cannot properly

be imposed for petitioners' failure to file declarations of estimated tax in 1951, 1952 and 1953.

III.

PENALTIES BASED UPON AMOUNTS ERRONEOUSLY HELD TO BE INCOME SHOULD NOT BE SUSTAINED

The Tax Court determined penalties against petitioners in its decision below (R. 70). Each of these penalties was computed as a percentage of an amount held to be income, pursuant to I.R.C. (1939) §§294 (d) (1) (A) and 294 (d) (2). It is clear that insofar as the amounts held to be income were not income, the penalties thereupon were erroneous and should not be sustained.

CONCLUSION

Petitioners submit that the contingent liability reserve withheld from them did not accrue as income unless and until released to them; that penalties for substantial underestimation were not incurred by failure to file declarations of estimate; that penalties based upon amounts erroneously held to be income should not be sustained; and that the foregoing errors render erroneous the decision below wherein the Tax Court determined deficiencies for 1951, 1952 and 1953 totalling $8,240.20.

Wherefore petitioners pray that the decision of the Tax Court be held erroneous and be reversed.

Respectfully submitted,

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Attorney for Petitioners.

APPENDIX

Joint Exhibit 5-E, at page 39 of the record, was stipulated at R. 6.

No. 15,821

In the United States Court of Appeals for the Ninth Circuit

JOHN R. HANSEN and SHIRLEY G. HANSEN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum opinion of the Tax Court (R. 65-68) is not officially reported.

JURISDICTION

This petition for review (R. 74) involves deficiencies in federal income tax for 1951, 1952 and 1953, in the respective amounts of $1,092.66, $686.40, and $3,221.46, plus penalties,[1] for substantial underesti-

[1] In this appeal the taxpayer is not disputing the penalties imposed for failure to file declarations of estimated tax

mation of estimated tax, in the amounts of $565.10, $375.67, and $355.10. Taxpayer's income tax returns were filed with the Collector of Internal Revenue at Tacoma, Washington. On January 27, 1956, the Commissioner of Internal Revenue mailed the taxpayer a notice of deficiency in the total amount of $6,903.30, plus penalties of $3,525.11. (R. 7, 15-25.) Within 90 days thereafter, and on April 26, 1956, taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 3.) An amended petition was filed at the hearing on February 11, 1957. (R. 3, 7-25.) The decision of the Tax Court was entered on August 5, 1957. (R. 70.) The case is brought to this Court by a petition for review filed November 4, 1957. (R. 74-75.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. During 1951, 1952 and 1953, taxpayer, an accrual basis automobile dealer, assigned conditional sales contracts to a finance company in exchange for the amounts set forth in the contracts. A part of the proceeds of the sale of the contracts was withheld by the finance company and credited to a reserve account

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under 1939 Code Section 294(d)(1)(A) in the respective amounts of $847.66, $563.51 and $532.64. (R. 70; Br. 3.) For convenience, John R. Hansen will be referred to herein as the taxpayer, although Shirley G. Hansen is also a petitioner, inasmuch as she filed joint returns with her husband for the taxable years involved.

in the taxpayer's name on the finance company's books. Were the amounts withheld and credited to the reserve account income to the taxpayer in the years withheld and credited?

2. Where taxpayer filed no declarations of estimated tax in 1951, 1952 and 1953, and has conceded his liability for penalties imposed under 1939 Code Section 294(d)(1)(A), is taxpayer liable for penalties for a substantial underestimation of estimated tax for the taxable years under 1939 Code Section 294(d)(2)?

STATUTES AND OTHER AUTHORITIES INVOLVED

The applicable provisions of the Statute and other authorities are printed in the Appendix, *infra*.

STATEMENT

A portion of the facts was stipulated. (R. 5-6.) The findings of the Tax Court (R. 61-65) may be summarized as follows:

Taxpayer is a Buick automobile dealer engaged in the business of selling automobiles at retail, under conditional sales contracts providing for payment of the purchase price in installments, using a form of contract provided by the General Motors Acceptance Corporation (hereinafter referred to as GMAC). This contract called for a "Total Time Price" for the automobile sold. This price was computed by subtracting the down payment including the trade-in, if any, from the "Cash Sale Delivered Price" and adding to this difference the cost of any insurance and finance charges. Thus an amount was arrived at

called the "Time (Deferred) Balance." The down payment was added back to the latter amount to fix the "Total Time Price." (R. 61.)

The form contract included the following endorsement, which was executed by taxpayer upon assignment of the contract to GMAC (Stip. Ex. 5-E; R. 6, 39-40, 62-63):

> For value received, undersigned does hereby sell, assign and transfer to the General Motors Acceptance Corporation his, its or their right, title and interest in and to the within contract, herewith submitted for purchase by it, and the property covered thereby and authorizes said General Motors Acceptance Corporation to do every act and thing necessary to collect and discharge the same.
>
> The undersigned certifies that said contract arose from the sale of the within described property, warranting that title to said property was at time of sale and is now vested in the undersigned free of all liens and encumbrances; that said property is as represented to the purchaser of said property by the undersigned and that statements made by the purchaser of said property on the statement form attached hereto are true to the best of the knowledge and belief of the undersigned.
>
> In consideration of your purchase of the within contract, undersigned guarantees payment of the full amount remaining unpaid hereon, and covenants if default be made in payment of any instalment herein to pay the full amount then unpaid to General Motors Acceptance Corporation upon demand, except as otherwise provided by the terms of the present General Motors Ac-

ceptance Corporation Retail Plan. Liability of the undersigned shall not be affected by any indulgence, compromise, settlement, extensions or variation of terms of the within contract effected with, or by the discharge or release of the obligation of the purchaser or any other person interested, by operation of law or otherwise. Undersigned waives notice of acceptance of this guaranty and notices of non-payment and nonperformance.

Taxpayer financed all of his conditional sales during 1951, 1952, and 1953 through GMAC. He assigned his contracts pursuant to the terms of the endorsement contained thereon, in exchange for the amount set forth in the contract, but reduced by an amount withheld and placed in a reserve account. There was no specific contract with GMAC requiring taxpayer to assign any of his contracts to GMAC. Taxpayer was not required to assign any of his contracts to GMAC or to any other finance company and could hold such contracts himself without assignment. (R. 63.)

A reserve account was maintained between taxpayer and GMAC under which at least 5% of the outstanding balances of the contracts assigned to GMAC were retained by it. This reserve was maintained in order to protect GMAC against any loss arising from the repossession of any automobile in case of default in payment. Also, in the event of prepayment by a customer, the proportionate reduction in finance charges was charged to the reserve. (R. 63-64.)

Taxpayer's books of account and income tax re-

turns were maintained and filed on an accrual method of accounting. Taxpayer had opening and closing inventories and accounts receivable. He charged off bad debts specifically as they became worthless. (R. 64.)

In reporting income from his automobile business and in maintaining his accounts, taxpayer debited the amount placed in the reserve to an account entitled "Due Finance Company" and credited an account entitled "Reserve for Repossession." In his income tax returns for 1951 and 1953 taxpayer did not include in income the amounts withheld by GMAC.[2] These amounts were placed in the reserve account. Taxpayer reported the amounts retained in the reserve account as income in the years when such amounts were paid to him by GMAC. (R. 64.)

Taxpayer did not file a declaration of estimated tax for any of the years in controversy. (R. 64.)

The Tax Court affirmed the Commissioner's deficiency determination, holding (1) that the amounts retained in the reserve account were a part of taxpayer's gross income in the years when the amounts were placed in the reserve account; and (2) that the additions to tax determined under Code Section 294 (d) (1) (A) for failure to file declarations of estimated tax and under Code Section 294(d) (2) for substantial underestimation of estimated tax were properly determined by the Commissioner. (R. 64-65.)

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[2] Taxpayer included $4,462.27 from amounts withheld in the reserve account in his gross income in 1952 and also included the same amount in 1953 income. The Tax Court made adjustment to reduce 1953 income by the duplicated amount. (R. 72.)

SUMMARY OF ARGUMENT

1. The Tax Court correctly held that amounts withheld by GMAC in purchasing conditional sales contracts from the taxpayer, an accrual basis automobile dealer, which amounts were credited to a reserve account in taxpayer's name on the finance company's books, were includible in the taxpayer's gross income for income tax purposes in the years withheld and credited. Since the taxpayer was on the accrual basis, the entire profit to him from the sale of the automobiles was properly includible in his gross income at the time of sale, even though some deferred payments would not be received until a subsequent period, and even though there was a possibility that the purchasers would default. Taxpayer's practice of accruing less than the entire sales price is inconsistent with the accrual method of accounting.

The finance company took no part in the sales, which were solely between the purchaser and the taxpayer. The transaction was complete at the time the down payment was made and the conditional sales contract executed, and at that time the taxpayer had an enforceable right to receive the remainder of the purchase price. The entire profit should be accrued at that time regardless of when received, and no portion of the profit is rendered non-taxable at that time because the contracts were sold to the GMAC under an arrangement by which a percentage of the selling price was retained as security.

There is no merit to taxpayer's argument that the amount which he will receive from the reserve ac-

count is so uncertain that he might never receive anything. Ultimately only two things can happen to the funds in the dealer reserve account, either the amounts will be paid to the taxpayer in cash or they will be used to satisfy taxpayer's other obligations to the finance company. There is no showing that the amounts in the reserve would not be collectible at the appropriate time or that their collection would be improbable.

The sale of the automobiles by the taxpayer to individual purchasers and the sale of the contracts to the finance company were separate transactions, but whether regarded as one or two transactions, in either case the only thing which would prevent the taxpayer from receiving the full sales price would be a purchaser's default, which is not a contingency sufficient to defer the accruing of income that has already been earned.

The Tax Court's decision is fully in accord with decisions of the Supreme Court, of this Court, and of the Tax Court, as well as with rulings of the Commissioner and with consistent administrative practice. It is respectfully urged that the cases of *Johnson* v. *Commissioner*, 233 F. 2d 952 (C.A. 4th); *Texas Trailercoach, Inc.* v. *Commissioner*, 251 F. 2d 395 (C.A. 5th); and *West Pontiac, Inc.* v. *Commissioner* (C.A. 5th), decided February 6, 1958 (1 A.F.T.R. 2d 58-839), were incorrectly decided and that they should not be followed here.

2. The Tax Court properly held that taxpayer was liable in 1951, 1952 and 1953 for penalties for substantial underestimation of estimated tax under Sec-

tion 294(d)(2) of the Internal Revenue Code of 1939. Taxpayer did not file any declarations of estimated tax in the taxable years, and he has not appealed from the addition to tax imposed by Code Section 294(d)(1)(A) for failure to file such declarations. The applicable Treasury Regulations provide that where no declaration is filed the amount of the estimated tax is zero. This provision has been sustained by the Tax Court, and is fully supported by the legislative history of the Code. It has not been shown to be unreasonable or inconsistent with the language of the Code it interprets. Moreover, the provision has been continued in the Regulations without substantial change during frequent reenactment of the Code Section involved, and Congress has never indicated disapproval of it. The Tax Court has repeatedly held that a failure to file a declaration results in a zero amount of estimated tax and that an addition for substantial underestimation may also be imposed if any tax is found to be due. Several District Courts have reached the same conclusion. The Tax Court's decision here is fully in accord with the language of the Code, with its legislative history, and with the applicable Treasury Regulations, all of which show a clear intent that both additions should be applicable for the same taxable year.

ARGUMENT

I

The Tax Court Correctly Held That Amounts Withheld By GMAC In Purchasing Conditional Sales Contracts From The Taxpayer, An Accrual Basis Automobile Dealer, Which Amounts Were Credited To A Reserve Account In His Name On The Finance Company's Books, Were Includible In Taxpayer's Income In The Years Withheld And Credited

The principal issue in this case is whether the Tax Court erred in holding that the Commissioner correctly included in taxpayer's gross income for 1951, 1952 and 1953 amounts credited to a dealer reserve account in taxpayer's name on the books of GMAC, the finance company to which taxpayer sold conditional sales contracts executed by purchasers of automobiles. Taxpayer contends (Br. 7-16) that these amounts were not includible in gross income at the time credited to the taxpayer by the finance company, and that the amounts should be accrued as income only when received, although taxpayer is on the accrual basis of accounting. (R. 64). We submit that there is no merit to this argument and that the Tax Court correctly sustained the Commissioner's determination.

Taxpayer made automobile sales under conditional sales contracts providing for payment of the purchase price in installments, the "Total Time Price" being computed by subtracting the down payment and/or trade-in, if any, from the "Cash Sale Delivered Price" and adding to this difference the cost of any insurance and finance charges. The down payment

was added to the resulting "Time (Deferred) Balance" to fix the "Total Time Price." (R. 61.)

Inasmuch as taxpayer was on the accrual basis (R. 64), the entire selling price of the automobile was includible in gross income at the time the contract with the purchaser was executed, and the entire profit remaining after the cost of the automobile was deducted was taxable net income in the year of sale. *Spring City Co.* v. *Commissioner*, 292 U.S. 182; *Shoemaker-Nash, Inc.* v. *Commissioner*, 41 B.T.A. 417. The entire profit was taxable in the year of sale even though many of the deferred payments would not actually be received until a subsequent year (*Dally* v. *Commissioner*, 227 F. 2d 734 (C.A. 9th), certiorari denied, 351 U.S. 908; *Clark* v. *Woodward*, 179 F. 2d 176 (C.A. 10)), and even though there was a possibility of default by purchasers of the automobiles (*Spring City Co.* v. *Commissioner*, 292 U.S. 182).

In *Clark* v. *Woodward Construction Co.*, 179 F. 2d 176 (C.A. 10th), the taxpayer had done highway construction work for the Highway Commission of Wyoming. After the work was completed and accepted by the Commission, all but 15% of the contract price was paid to the taxpayer in 1942. That 15% was withheld pursuant to a state statute in order to give 40 days notice of final settlement and acceptance of the work to persons who might have claims against the contractor. The court held that the accrual basis taxpayer should have accrued and reported the entire amount of the contract price in 1942 when the liability to it was determined and became fixed. It pointed out that, although any claims made

by third persons against the contractor would be paid from amounts withheld, any such payment would be paid from withheld money belonging to the taxpayer, and that for such payments the taxpayer could have claimed deductions.

In *Dally* v. *Commissioner*, 227 F. 2d 724 (C.A. 9th), certiorari denied, 351 U.S. 908, there was a contract between the taxpayer and the Government for the construction of prefabricated housing units, payment to be made on the basis of periodic estimates of completion of work, certified to by the taxpayer and the Government.[3] The taxpayer contended that it did not need to accrue the percentage of the contract price allocable to work performed in the taxable year inasmuch as the periodic estimates were not certified to until after the close of the taxable year. In denying taxpayer's contention, this Court stated (p. 497-8):

> The facts here bring the case within the principle of *Continental Tie & Lumber Co.* v. *United States*, 286 U.S. 290, 295, 52 S. Ct. 529, 76 L. Ed. 1111, which holds that income may not be deferred after the right matures, even although the ministerial act of computing the amount occurs in the subsequent year, and this although

[3] It should perhaps be mentioned that in that case 10% of the contract price was retained by the Government until final acceptance of all the work under the contract. The amount withheld, however, was not in issue in the appeal, and is in no way analogous to the dealer reserve in issue here, inasmuch as it was agreed by both parties that the right to that 10% had not matured in the taxable year since the work had not been finished and accepted.

> the administrative procedure to ascertain the amount to be paid is that of a public commission. * * * [The] mere mechanical act of making out the necessary voucher did not operate to postpone the accrual of the sum which had been earned. *Commissioner of Internal Revenue* v. *Dumari Textil Co.*, 2 Cir., 142 F. 2d 897, 899-900. Sums payable because earned are not rendered contingent and nonaccrued by the mere fact that some additional acts are necessary in order to make the collection, even if those acts must be performed later by third persons or by the government. *Automobile Ins. Co.* v. *Commissioner*, 2 Cir., 72 F. 2d 265, 267-268. Thus this court has held that a sum payable under a judgment against the United States is accruable in the year when the judgment becomes final notwithstanding Congress has yet to make the necessary appropriation to enable the judgment creditor to get his money. *H. Liebes & Co.* v. *Commissioner*, 9 Cir. 90 F. 2d 932, 939.

Because the taxpayer in the instant case was financially unable to hold the conditional sales contracts until maturity and still carry the necessary car inventories, he sold the contracts to GMAC. Each sale, however, was a transaction solely between the purchaser and the taxpayer, in which the finance company took no part. Although taxpayer used the forms of conditional sales contract furnished by GMAC, he had no specific contract with GMAC requiring him to assign any of his contracts to that finance company, or to any other finance company, and he could have held such contracts himself without assignment if he had been able to do so. (R. 33-34, 63.) Each sale

was a transaction solely between the purchaser and the taxpayer. (Ex. 5-E; R. 39.) At the time the taxpayer and the purchaser agreed on the selling price and the taxpayer received the down payment, together with the conditional sales contract for the remainder of the selling price plus finance charges, insurance, etc., the transaction was complete and the taxpayer had the right to receive the remainder of the purchase price.

Since the taxpayer used the accrual method of accounting, his entire profit from the sale should be reported when it accrued, regardless of when received. Taxpayer, however, confuses the time his enforceable right to the sales price of the automobile arose under the purchaser's agreement to buy in the taxable years involved with a later date when he would receive the entire sales price. The Commissioner contends that no portion of the profit on the sale of an automobile is rendered currently nontaxable because the taxpayer sold the contracts under an agreement by which a percentage of the selling price was retained as security by the finance company. The contracts were sold for amounts equal to the unpaid balance on the sales price. (R. 63.)

When a contract was sold the taxpayer endorsed it to the finance company guaranteeing payment of the full amount remaining unpaid. The amounts withheld and credited by the finance company to the dealer reserve account were at least 5% of the outstanding balances of the contracts assigned to GMAC. The amounts in the dealer reserve account were held to protect GMAC against any loss arising from the

repossession of any automobile in case of default in payment and also the reserve could be charged, in the event of prepayment by a purchaser, with the amount of the proportionate reduction of finance charges. (R. 63-64.) Taxpayer debited the amounts placed in the reserve by the finance company to an account entitled "Due Finance Company" and credited the amounts to an account called "Reserve for Repossession." (R. 64.) The amounts placed in the reserve were included in taxpayer's income only when they were actually received by him from GMAC. Payments to the taxpayer of amounts in the reserve in excess of approximately 5% of the outstanding balances of the contracts assigned to GMAC were made to taxpayer yearly in January or February. (R. 33.) During 1951 taxpayer failed to include $3,154.29 retained by GMAC in the reserve account, and also the sum of $12,953.97 withheld and retained in 1953. (R. 18, 21.)

The amounts set aside to the taxpayer's credit during the taxable years by GMAC were to be used to guarantee losses which might develop at some future time as a result of repossessions, but the record does not show what the incidence of loss on repossessions was during the period.

Taxpayer argues (Br. 10-11) that extreme contingencies governed payment which might prevent the dealer's receipt of any payment of the reserve. This contention is not supported by the record. While it is possible that the taxpayer would not receive cash, the reserve would in all events be used for the benefit of the taxpayer to satisfy future obligations to the

finance company. If the reserve were eliminated in the future its depletion would be due to the satisfaction of the taxpayer's liabilities to the finance company. Taxpayer confuses the arrangement with respect to *payment* of the sums in the reserve account with his absolute fixed right in the taxable years to receive definite sums credited to him at the time of sale and properly accruable at that time. The fact that the amounts in the reserve account were not immediately payable to the taxpayer is of no significance, for the important thing is that he had an enforceable right to the entire sales price of the automobiles sold during the taxable years. There was no uncertainty with respect to the amounts to which taxpayer became entitled in the taxable years. Those amounts were definitely fixed at the time they were credited by GMAC to the reserve account in his name. Only two things could ultimately occur with respect to these funds: either the amounts would be paid to the taxpayer in cash or they would be used to satisfy his other obligations to GMAC. There is no showing whatever that the amounts in the reserve accounts would not be collectible from GMAC at the appropriate time or that collection would be improbable. It thus cannot logically be argued that the reserve might never be realized by the taxpayer.

Contrary to taxpayer's contention (Br. 8-9), the sale of an automobile by the taxpayer to an individual purchaser and the sale of the contract to the finance company were two separate transactions. See *Raybestos-Manhattan Co.* v. *United States*, 296 U.S. 60. However, whether the sale of an automobile and the

sale of the contract were one or two transactions is really immaterial, for in either case the only thing that would prevent the taxpayer from receiving the full sales price would be the default of a purchaser which, as pointed out earlier in this brief, is not a contingency sufficient to defer the accruing of income that has already been earned. *Spring City Co.* v. *Commissioner*, 292 U.S. 182.

An analogous situation exists in instances where deductions have been held allowable as accrued expenses in the taxable year when all facts have occurred which determine that the taxpayer has incurred a liability. See *Pacific Grape Products Co.* v. *Commissioner*, 219 F. 2d 862 (C.A. 9th); *Ohmer Register Co.* v. *Commissioner*, 131 F. 2d 682 (C.A. 6th); *Air-Way Electric Appliance Corp.* v. *Guitteau*, 123 F. 2d 20 (C.A. 6th).

The Commissioner has consistently ruled that amounts withheld by finance companies to cover possible losses on notes purchased from dealers in trailers and automobiles constitute income to dealers using the accrual method of accounting at the time the credit is made in favor of the dealer by the finance company, even though the dealer is not immediately or even currently able to draw on the entire reserve. See Rev. Rul. 57-2, Appendix, *infra*, reaffirming the earlier ruling, G.C.M. 9571, X-2 Cum. Bull. 153 (1931). This recent ruling holds that the time for accrual of the reserve is not affected by the fact that some part or all of the reserve may be used to cover worthless notes in the future, since whenever notes become worthless the dealer's bad debt

deduction must be separately established under 1954 Code Section 166 relating to bad debts. There is no remote contingency in the present case which would distinguish it from the facts involved in that ruling. The ruling makes clear (p. 155) that a remote contingency which cannot reasonably be accrued for income tax purposes "must, however, be something more than the mere possibility of the debtor not satisfying his indebtedness." Again it states (p. 155):

> There is always a possibility, where the relationship of debtor and creditor exists, that the debtor may not pay, due to financial reverses, but if the possibility of such failure to pay is accepted as a reason for not accruing an item of income the whole theory of the accrual method of accounting must fall where commercial transactions are concerned.

The instant case does not involve the question whether taxpayer may establish a reserve for bad debts. Although Section 23(k) of the Internal Revenue Code of 1939, Appendix, *infra*, permits the deduction of either specific debts which become worthless within the taxable year or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts, the taxpayer chose to use the specific debt charge-off method for bad debt (Exs. 1-A, 2-B, 3-C; R. 5, 37, 64) and should not be allowed any further deduction.

The Board of Tax Appeals relied on G.C.M. 9571, *supra*, in *Shoemaker-Nash, Inc.* v. *Commissioner*, 41 B.T.A. 417, where an accrual basis taxpayer sold notes received in partial payment on automobiles to

certain finance companies. Each company withheld a portion of the purchase price of the notes and credited it to the dealer on its books in a reserve account. As in the instant proceeding, the reserve was held as partial security for the dealer's obligations to the finance company. The agreement between Shoemaker-Nash, Inc., and the General Contract Purchase Corporation provided that, at any time any obligation of the dealer which was covered by the reserve became due and unpaid, the finance company could apply the reserve against the obligation. That provision is similar in all material respect to the agreement with the finance company in the instant proceeding. The Board of Tax Appeals there held that the taxpayer should report as income all amounts credited to the reserve accounts each year even though nothing was released from the accounts during the year. That case has been followed in many Tax Court decisions, which uniformly hold that dealer reserves belong absolutely to the dealer, and that provisions with respect to the *payment* of the reserves cannot serve to take from income amounts credited which would normally be determinative of his tax liability where a taxpayer is on the accrual basis. See *Kilborn* v. *Commissioner*, 29 T.C. 14, pending on appeal to the Fifth Circuit; *Evans Motor Co.* v. *Commissioner*, 29 T.C. No. 62; *Baird* v. *Commissioner*, decided October 9, 1957 (1957 P-H T.C. Memorandum Decisions, par. 57, 192), pending on appeal to the Seventh Circuit; *Schaeffer* v. *Commissioner*, decided April 30, 1957 (1957 P-H T.C. Memorandum Decisions, par. 57,068) pending on appeal

to the Sixth Circuit; *Glover* v. *Commissioner*, decided March 18, 1957 (1957 P-H T.C. Memorandum Decisions, par. 57,045), pending on appeal to the Eighth Circuit; *West Pontiac, Inc.* v. *Commissioner*, 27 T.C. 749, reversed, February 6, 1958 (C.A. 5th) (1 A.F.T.R. 2d 58-837); *Texas Trailercoach, Inc.* v. *Commissioner*, 27 T.C. 575, reversed, 251 F. 2d 395 (C.A. 5th); *Brodsky* v. *Commissioner*, 27 T.C. 216; *Wm. Koch Motors, Inc.* v. *Commissioner*, decided December 30, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,334); *Central Motors, Inc.* v. *Commissioner*, decided August 12, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,228); *Ray Woods Used Cars, Inc.* v. *Commissioner*, decided September 30, 1952 (1952 P-H T.C. Memorandum Decisions, par. 52,290); *Town Motors, Inc.* v. *Commissioner*, decided July 24, 1946 (1946 P-H T.C. Memorandum Decisions, par. 46,173); *Royal Motors, Inc.* v. *Commissioner*, decided July 12, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,255); *Colorado Motor Car Co.* v. *Commissioner*, decided March 25, 1940 (1940 P-H T.C. Memorandum Decisions, par. 40,178).

The case of *Keasbey & Mattison Co.* v. *United States*, 141 F. 2d 163 (C.A. 3d), on which taxpayer relies (Br. 11-12), is distinguishable on its facts. See *Evans Motor Co.* v. *Commissioner*, 29 T.C. No. 62. In that case a taxpayer sold asbestos products manufactured by it to dealers and distributors, who sold to retailers or applicators, who in turn sold to home owners. Upon the termination of Federal Housing Authority financing in 1936, with respect to which

F.H.A. had guaranteed to the applicators the notes given in payment by the home owners, the taxpayer contracted with a finance company (p. 164) "to discount, for *applicators*," (italics supplied) notes of home owning purchasers of the taxpayer's products for which service the finance company was to make a charge of seven per cent of the amount of the notes so discounted. Five of the seven per cent charge was to go to the finance company as compensation for its financing services, and the balance (two per cent) was to be placed in a reserve fund by the finance company to liquidate possible losses from uncollectible notes. The contract further provided that whenever the total reserve fund should exceed ten per cent of the unpaid balance of the outstanding discounted notes such excess should be paid to the taxpayer at its option and upon termination of the agreement any balance remaining in the reserve fund was to be paid to the taxpayer. The contract also contained an express assumption of liability on the part of the taxpayer to the finance company for unpaid notes, in addition to the protection afforded by the reserve, up to ten per cent of the aggregate amounts of notes discounted. It is thus clear that the taxpayer in that case was not selling notes to the finance company as in *Shoemaker-Nash Inc.* v. *Commissioner*, 41 B.T.A. 417, and as in the instant case, but the finance company was merely discounting notes for the retailers or *applicators* of taxpayer's products. Since a materially different factual situation was involved, it is unnecessary to discuss here whether the decision of the Third Circuit was correct.

A more recent Third Circuit case is believed to be more in point here. In *Wayne Title & Trust Co.* v. *Commissioner*, 195 F. 2d 401, the court held that title insurance premiums are fully earned when received and that this characteristic is not destroyed by the requirement of Pennsylvania law that a portion of such premiums or an equivalent sum be set aside and retained in a reinsurance reserve fund. The rationale of that case is analogous to and in accord with the Tax Court's decision here. Since it is a later decision than the *Keasbey & Mattison Co.* case, it should be given more weight than the earlier decision of that Circuit.

Another analogous situation was presented in *Whitney Corp.* v. *Commissioner*, 105 F. 2d 438 (C.A. 8th), where during a reorganization there was a transfer of assets of a subsidiary corporation to a new corporation in exchange for another corporation's preferred stock, most of which was deposited with a trust company in escrow as a guaranty of stated minimum earnings of the new corporation. The court there held that the profit from the transfer was taxable in the year during which the stock was issued and deposited in escrow, at which time the rights of the parties were definitely fixed and ascertainable, not in the year when the escrow period ended. See also *Bonham* v. *Commissioner*, 89 F. 2d 725 (C.A. 8th).

Again, the case of *Commissioner* v. *Cleveland Trinidad Pav. Co.*, 62 F. 2d 85 (C.A. 6th), upon which taxpayer relies (Br. 11), is not in point here. The taxpayer there did not have an unqualified right to receive the full amount of the contract price for paving and maintaining pavements, but the municipalities

were to retain a portion to guarantee the maintenance of the pavements for the periods specified. There was no provision that the taxpayer would ultimately receive any portion of the amounts withheld. The court pointed out that the sum withheld for maintenance might be materially reduced in the event of necessary repairs or subsequent disclosure of a failure to comply with specifications. In the instant case, there was no guarantee on the part of the taxpayer to maintain the automobiles after they were sold.

The taxpayer also relies on *Johnson* v. *Commissioner*, 233 F. 2d 952 (C.A. 4th) (Br. 12); *Texas Trailercoach, Inc.* v. *Commissioner*, 251 F. 2d 395 (C.A. 5th) (Br. 13-15); and *West Pontiac, Inc.* v. *Commissioner*, (C.A. 5th), decided February 6, 1958 (1 A.F.T.R. 2d 58-837) (Br. 15). It is the Commissioner's position that these cases were wrongly decided, and he respectfully urges that they should not be followed as a precedent here.

It is submitted, therefore, on the basis of the record, and well-settled principles of accrual accounting the Tax Court correctly held that the amounts credited to the taxpayer in the dealer reserve account in the taxable years should properly be accrued as income in those years.

II

The Tax Court Properly Held That Taxpayer Was Subject To Penalties For Substantial Underestimation Of Estimated Tax Under Section 294(d)(2) Of The Internal Revenue Code Of 1939

Taxpayer did not file declarations of estimated tax for the taxable years 1951, 1952 and 1953. (R. 64.)

The Commissioner asserted penalties or additions to tax under Section 294(d)(1)(A), Appendix, *infra*, for failure to file declarations of estimated tax, and also under Section 294(d)(2), Appendix, *infra*, for substantial underestimation of estimated tax. (R. 17.) The Tax Court sustained the imposition of both penalties. (R. 67-68.) Taxpayer has appealed only with respect to the addition to tax imposed by Section 294(d)(2). (R. 82-83; Br. 3, 16-20.)

To Section 294(a), were added, by Section 5(b) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, subsections (3), (4) and (5), which contain three sanctions designed to give force to the obligation there imposed on taxpayers for the first time to make declarations and payments of estimated taxes. These are additions to tax in the case of (3) failure to file timely a declaration of estimated tax; (4) failure to pay installments of estimated tax, and (5) substantial underestimation of the estimated tax.

Section 294(d)(2) provides that "If 80 per centum of the tax * * * exceeds the estimated tax * * *, there shall be added to the tax an amount * * * equal to 6 per centum of the amount by which such tax so determined exceeds the estimated tax * * *." Taxpayer argues (Br. 16-20) that because he failed to file a declaration of estimated tax he cannot be said to have underestimated it.

However, Treasury Regulations 118, Section 39.294-1(b)(3)(a) Appendix, *infra*, provides that "In the event of a failure to file the required declaration, the amount of the estimated tax for the purposes of this

provision is *zero.*" [4] (Italics supplied.)

Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the statute which they interpret; they are not to be overruled except for weighty reasons. *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501, rehearing denied, 334 U.S. 813; *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378; *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 103; *Brewster* v. *Gage*, 280 U.S. 327.

The leading Tax Court decision, *Fuller* v. *Commissioner*, 20 T.C. 308, affirmed on other issues, 213 F. 2d 102 (C.A. 10th), rejected attack on the above Treasury Regulations in the following language (p. 316):

> The petitioners attack the regulation as being void in that it "distorted the will of Congress." The regulation is couched in the same language used by Congress in its Conference Report on legislation covering this subject and follows the procedure therein prescribed. It therefore appears that the regulation actually reflects, rather than distorts, the will of Congress, and we uphold its validity.

Both the Senate Report and Conference Report (S. Rep. No. 221, 78th Cong., 1st Sess., p. 42 (1943 Cum. Bull. 1283, 1345); H. Conference Rep. No. 510, 78th Cong., 1st Sess., p. 56) (1943 Cum. Bull. 1351, 1372) provided as follows:

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[4] The same provision appears in Treasury Regulations 111, Section 29.294-1 (b) (3) applicable to the taxable year 1951.

> In the event of a failure to file any declaration where one is due, the amount of the estimated tax for the purposes of this provision will be zero.

Moreover, Treasury Regulations "long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill*, 305 U.S. 79, 83; *Gus Glass Co.* v. *Commissioner*, 204 F. 2d 327 (C.A. 8th). Congress has seen fit substantially to re-enact the sections here involved several times since 1943.[5] It has in no way indicated disapproval of the Treasury Department's interpretation of the statute as reflected in its Regulations. The re-enactment doctrine should have, therefore, considerable force. *Helvering* v. *Winmill, supra.*

That the additions to tax may be imposed for both failure to file a declaration and for a substantial underestimate in the same taxable year is also shown by the Committee Reports to the 1954 Code. The 1954 Code eliminated the addition to tax for failure to file a declaration (Section 6651(c) (26 U.S.C. 1952 ed., Supp. II, Sec. 6651)) except in the case of wilful

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[5] The following amendments and re-enactments have been made to these provisions without disturbing the regulative provision here in dispute. Section 118(a), Revenue Act of 1943, c. 63, 58 Stat. 21; Section 13(a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231; Section 202(a), Revenue Act of 1948, c. 168, 62 Stat. 110; Section 2, Act of January 2, 1951, c. 1195, 64 Stat. 1136; Section 208(d)(4), Social Security Act Amendments of 1950, c. 809, 64 Stat. 477; Section 221(g), Revenue Act of 1950, c. 994, 64 Stat. 906; and Section 103(b), Revenue Act of 1951, c. 521, 65 Stat. 452.

failure (Section 7203 (26 U.S.C. 1952 ed., Supp. II, Sec. 7203)). The 1954 Code combined the three additions into a single one for underpayment of the estimated tax and based the addition upon six per cent per annum of the amount of the underpayment for the period of the underpayment. Section 6654 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6654).

In explaining this change the Committee Reports point out that under the 1939 Code additions to tax for failure to file a declaration and for a substantial underestimate would both apply for the same taxable year, stating (H. Rep. No. 1337, 83d Cong., 2d Sess., p. 100 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4127):

> Additional charges are imposed under the present law for failure to file a declaration or make a payment of the estimated tax or for substantial underestimates of tax liability. These charges may be severe. For failure to file a declaration or to pay an installment of the estimated tax, the total charge may be as high as 9 percent of the unpaid installment. For a substantial underestimate of tax, that is, an estimated tax which is less than 80 percent of the actual tax liability for the year (66⅔ per cent in the case of farmers), a charge of 6 percent of the amount by which the final tax liability exceeds the estimated tax may be imposed. This charge and the charge for failure to file a declaration or pay an installment of estimated tax may run concurrently and result in a combined charge of 15 percent of the estimated tax due.

See also S. Rep. No. 1622, 83d Cong., 2d Sess., p. 135 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4769).

In conformity with the above legislative history and Regulations, the Tax Court has repeatedly held that a failure to file a declaration results in a zero amount of estimated tax, and that an addition for a substantial underestimate may also be imposed if any tax is found to be due. Following are a few of the Tax Court decisions: *Fuller* v. *Commissioner*, 20 T.C. 308, affirmed on other grounds, 213 F. 2d 102 (C.A. 10th); *Baumgardner* v. *Commissioner*, decided May 9, 1956 (1956 P-H T.C. Memorandum Decisions, par. 56, 112), affirmed on other grounds, 251 F. 2d 311 (C.A. 9th); *Clayton* v. *Commissioner*, decided January 25, 1956 (1956 P-H T.C. Memorandum Decisions, par. 56,021), affirmed, 245 F. 2d 238 (C.A. 6th); *Fogel* v. *Commissioner*, decided June 30, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,185), affirmed, *per curiam*, 237 F. 2d 917 (C.A. 6th); *Acker* v. *Commissioner*, decided January 28, 1957 (1957 P-H T.C. Memorandum Decisions, par. 57,017), pending on appeal to the Sixth Circuit; *Abbott* v. *Commissioner*, 28 T.C. 798, pending on appeal to the Third Circuit; *Patchen* v. *Commissioner*, 27 T.C. 592, pending on appeal to the Fifth Circuit; *Kaltreider* v. *Commissioner*, 28 T.C. 121, pending on appeal on other issues in the Third Circuit; *Beacham* v. *Commissioner*, 28 T.C. 598, pending on appeal on other issues in the Fifth Circuit.

Several District Courts have reached the same conclusion as the Tax Court. *Erwin* v. *Granquist* (Ore.), decided May 10, 1957 P-H, par. 72,786), affirmed, *per curiam*, February 13, 1958 (C.A. 9th) (1 A.F. T.R. 2d 58-978), taxpayer's petition for certiorari

pending; *Palmisano* v. *United States* (E.D. La.), decided January 22, 1958 (1 A.F.T.R. 2d 58-934), pending on appeal to the Fifth Circuit; *Farrow* v. *United States*, 150 F. Supp. 581 (S.D. Cal.); *Peterson* v. *United States*, 141 F. Supp. 382 (S.D. Tex.). It is true, as taxpayer notes (Br. 18-19), that a few District Courts have held that the addition to tax under Section 294(d)(2) cannot be applied where no declaration of estimated tax was filed. These cases stem from *United States* v. *Ridley*, 120 F. Supp. 530 (N.D. Ga.), decided in 1954. See also *Barnwell* v. *United States* (E.D. S.C.), decided February 4, 1958 (1 A.F.T.R. 2d 58-995); *Jones* v. *Wood*, 151 F. Supp. 678 (Ariz.); *Stenzel* v. *United States*, 150 F. Supp. 364 (N.D. Cal.); *Powell* v. *Granquist*, 146 F. Supp. 308 (Ore.), affirmed on another issue, 252 F. 2d 56 (C.A. 9th); *Owen* v. *United States*, 134 F. Supp. 31 (Nebr.), appeal dismissed, 232 F. 2d 894 (C.A. 8th).

The Revenue Service has announced it will adhere to *Fuller* v. *Commissioner*, *supra*, and will not follow *United States* v. *Ridley*, *supra*. Rev. Rul. 55-224, 1955-1 Cum. Bull. 414.

The District Court in *Ridley*, *supra*, reasoned that both sanctions could not stand and therefore that the lesser (Sanction 294(d)(2)) should fall on the theory that no estimate had been made. The results that may flow from the *Ridley* decision are well illustrated by *Jones* v. *Wood*, 151 F. Supp. 678 (Ariz.). There taxpayer filed no declarations of estimated tax. The District Court first held, following *Ridley*, that the impost under Section 294(d)(2) could not stand; then it held the addition to tax under Section 294(d)

(1)(A) was excused on the grounds of reasonable cause. Thus, taxpayer paid nothing for failing to obey the law and retaining use of the money.

If Congress had not intended both sections to apply it could easily have so provided. The addition to tax for failure to pay, as provided in Section 294(d)(1)(B), is expressly limited to cases where a declaration of estimated tax was filed. Section 294(d)(2) has no similar provision making the penalties interdependent.

Section 294(d)(1)(A), which imposes an addition to tax for the failure to file, may not always apply as *Jones* v. *Wood*, *supra*, illustrates, for it may be excused on a showing of "reasonable cause." The Tax Court found reasonable cause lacking in the instant case. (R. 65.) Section 294(d)(2), however, contains no exculpatory language, which leads to the conclusion that Congress intended it to apply automatically whenever taxpayers failed by 20% or more to meet the statute's obligation. *Smith* v. *Commissioner*, 20 T.C. 663. It is not sensible to penalize the person who tries but misses by 20% regardless of reason (*Smith* v. *Commissioner*, *supra*), but to let go altogether the person who does not even file a declaration, if he had an excuse for his failure, as the court did in *Jones* v. *Wood*. Cf. *United States* v. *Koppers Co.*, 348 U.S. 254, 263.

We submit that the Tax Court and District Court decisions which apply both additions are clearly correct, and that they are fully in accord with the language of Section 294(d)(1)(A) and (d)(2), with the legislative history of the section's enactment and

with the applicable Treasury Regulations, all of which show a clear intent that both additions should be applicable for the same taxable year.

CONCLUSION

For the reasons stated, the decision of the Tax Court is correct and should be affirmed.

Respectfully submited,

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APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal service, or whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(k) [as amended by Sec. 113(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General rule.*—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period

(fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such methods as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.
(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.

* * * *

(d) [as added by Sec. 118(a), Revenue Act of 1943, *supra*] *Estimated Tax.*—

(1) [as amended by Sec. 13(b) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *Failure to file declaration or pay installment of estimated tax.*—

(A) *Failure to File Declaration.*—In the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month (except the first) or fraction thereof during which such amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10 per centum of the unpaid portion of such installment. For the purposes of this subparagraph the amount and due date of each installment shall be the same as if a declaration had been filed within the time prescribed showing an estimated tax equal to the correct tax reduced by the credits under sections 32 and 35.

* * * *

(2) [as amended by Sec. 6(b)(8) of the Individual Income Tax Act of 1944, *supra*] *Substantial underestimate of estimated tax.*—If 80 per centum of the tax (determined without regard to the credits under sections 32 and 35), in the case of individuals other than farmers exercising an election under section 60(a), or 66⅔ per centum of such tax so determined in the case of such farm-

ers, exceeds the estimated tax (increased by such credits), there shall be added to the tax an amount equal to such excess, or equal to 6 per centum of the amount by which such tax so determined exceeds the estimated tax so increased, whichever is the lesser. This paragraph shall not apply to the taxable year in which falls the death of the taxpayer, nor, under regulations prescribed by the Commissioner with the approval of the Secretary, shall it apply to the taxable year in which the taxpayer makes a timely payment of estimated tax within or before each quarter (excluding, in case the taxable year begins in 1943, any quarter beginning prior to July 1, 1943) of such year (or in the case of farmers exercising an election under section 60(a), within the last quarter) in an amount at least as great as though computed (under such regulations) on the basis of the taxpayer's status with respect to the personal exemption and credit for dependents on the date of the filing of the declarations for such taxable year (or in the case of any such farmer, or in case the fifteenth day of the third month of the taxable year occurs after July 1, on July 1 of the taxable year) but otherwise on the basis of the facts shown on his return for the preceding taxable year.

* * * *

(26 U.S.C. 1952 ed., Sec. 294.)

Treasury Regulations 118,[6] promulgated under the Internal Revenue Code of 1939:

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[6] Treasury Regulations 111, Sections 29.41-1, 29.41-2 and 29.294(b)(3)(4), applicable to the year 1951, are substantially similar to the quoted sections from Treasury Regulations 118.

Sec. 39.41-1 *Computation of net income.* Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items or gross income and deductions are to be accounted for. (See sections 39.42-1 to 39.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 39.41-2 *Bases of computation and changes in accounting Methods.*—(a) Approved standard method of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistence. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly unless in order clearly to re-

flect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See sections 39.42-2 and 39.43-3.) On the other hand, appreciation in value or property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see section 39.22(c)-5.)

* * * *

Sec. 39.294-1 *Additions to the tax.*—

* * * *

(b) *Additions for specific failures on the part of the taxpayer with respect to the estimated tax*—

* * * *

(3) *Substantial understatement of estimated tax.* (1) Section 294(d)(2) provides for an addition to the tax in the case of a taxpayer who makes a substantial underestimate of tax on his declaration. Such addition to the tax shall not apply to the taxable year in which falls the death of the taxpayer. Except as hereinafter provided—

(a) In the case of individuals, other than those exercising the election under section 60(a), relating to farmers, an addition to the tax under section 294(d)(2) is applicable in the event that the amount of the estimated tax (increased by the

amount of the credit for taxes withheld at source on wages under section 35 and the credit under section 32) is less than 80 percent of the tax imposed by chapter 1 for the taxable year (determined without regard to such credits). In the event of a failure to file the required declaration, the amount of the estimated tax for the purposes of this provision is zero.

* * * *

Rev. Rul. 57-2, 1957-1 Cum. Bull. 17:

Rev. Rul. 57-2

Amounts withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income to dealers employing accrual method of accounting, to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer, regardless of whether charges for worthless notes are also made to the account pursuant to an agreement between the parties. Losses sustained on worthless notes shall be separately established by the dealer as required by section 166 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state its position with respect to the treatment, for Federal income tax purposes, of amounts withheld by banks and finance companies to cover possible losses on notes purchased from automobile or other dealers employing the accrual method of accounting, and which are recorded on the books of the bank or finance company as a liability of the bank or finance company to the dealer.

The steps generally involved in transactions concerning automobile dealers are as follows: When a car is purchased on credit from a dealer, the purchaser makes a down payment, either in the form of cash or by turning in another car at an agreed value, the balance being satisfied by the purchaser's promissory note and a supporting conditional sales contract. The face amount of the note reflects two elements—the balance of what would be the purchase price of the car, if bought for cash, and a finance charge. As between the purchaser and the dealer, the transaction is closed and completed at this point with the attendant tax consequences to the dealer.

It is then common practice for the dealer to sell or discount the purchaser's note and sales contract to some financial institution. The finance company or bank acquires the note at a value somewhat less than its face value, the difference representing a charge for its service. Simultaneously, either cash or unrestricted credit is given to the dealer to the extent of the amount reflected in the face value of the note. That corresponds to the unpaid balance of the cash retail price of the car. The difference between the face value of the note and the sum of the finance company's charge and its credit or immediate payment to the dealer (representing part of the finance charge previously mentioned) is then credited on the books of the finance company as a liability of the finance company to the dealer. The accumulation of these credits is generally known as a "dealers reserve" and is the specific object of the present consideration.

Settlement of the liability represented by the reserve is subject to agreement between the particular dealer and the financial institution involved. In some instances, the agreement does not contemplate the charging of any items against the reserve account,

while in others the account reflects a running record of various transactions between the parties, that is, both credits and charges are entered, depending upon the nature of the item. Thus, in certain instances, the dealer and the finance company may agree that notes purchased or discounted are to be charged to the reserve account in the event they become worthless.

With regard to those instances where losses incurred by a finance company on the notes purchased from automobile dealers may not be charged against the reserve, the credits to the reserve, by the finance company in favor of a dealer who employs the accrual method of accounting constitute income to the dealer at the time such credit is made, even though the dealer is not immediately or even currently able to draw on the entire reserve. See G. C. M. 9571, C. B. X. 2, 153 (1931), and *Shoemaker-Nash, Inc.* v. *Commissioner*, 41 B. T. A. 417. The principles involved in the purchase of notes from automobile dealers by banks or finance companies as described above are equally applicable where notes are purchased, under similar conditions, from dealers in items other than automobiles.

Where a dealer's reserve is in the nature of a running account, the charging thereto of worthless notes pursuant to agreement between the parties has no bearing upon the fact that taxable income has been received by the dealer, or upon the time of its realization as otherwise evidenced by the credits to such reserve.

Accordingly, it is held that credits to such reserve, in the case of a dealer employing the accrual method of accounting, constitute income to the dealer at the time such credits are made regardless of whether changes to the account for worthless notes are also made pursuant to an agreement between the parties.

Losses sustained on worthless notes are to be separately established by the dealer as required by the provisions of section 166 of the Internal Revenue Code of 1954 relating to bad debts.

In arriving at these conclusions, consideration has been given the case of *Blaine Johnson et al* v. *United States*, 233 Fed. (2d) 952. See also, *Albert M. Brodsky, et us.* v. *Commissioner*, 27 T.C. No. 23.

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No. 15821

United States Court of Appeals

For the Ninth Circuit

JOHN R. HANSEN and SHIRLEY G. HANSEN, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF OF AMICI CURIAE

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BRIEF OF AMICI CURIAE

With leave of the Court, this brief is filed by the undersigned attorneys as *amici curiae* in the interest of various clients and other taxpayers who will be substantially affected by the decision in this case. Determination of the legal issue here presented will have fundamental implications to many taxpayers throughout the United States. There are many cases, in various stages of litigation, which will be directly affected by this decision.[1] There are presently pending in several other courts of appeal cases involving the fundamental principles to be decided in this case.[2]

SCOPE OF THE BRIEF

This brief is confined to a discussion of only one issue involved in this case. That issue is whether a dealer selling tangible, personal property on a deferred payment plan and using the accrual system of accounting should be required to take into income credits made by the

[1] See Brief p. 17-21

[2] See Brief p. 19...

financing institution to its "dealer's reserve account" at the time such credits are entered on the financing institution's books even though not available to the dealer.

The Tax Court in a recent series of cases has upheld the position of the Commissioner that dealer's system of accrual accounting, which reports these amounts in the year in which they become available to the dealer, is incorrect and that said credits to the dealer reserve account by the financing institution are taxable to the dealer in the year the amounts are credited to "a dealer reserve account" on the financing institution's books.

The various courts of appeal which have considered this question have uniformly reversed the Tax Court and the Commissioner and held that the dealer's accrual system is correct and such credits need not be accrued as income until the amounts carried in the reserves become available to the dealer.

As to the other points which may be here involved we express no opinion.

FACTS WITH RESPECT TO THE POINTS HEREIN ARGUED

The fundamental facts, with which this brief is concerned, involve a pattern of financing widely used and long established in the businesses of selling automobiles, trailers and similar property.

The factual pattern of this type of business as illustrated by this case involves three parties — the purchaser who desires to buy the article (be it a car, trailer, or other similar tangible property), the financing institution which supplies the money to the purchaser, and the dealer who sells the article to the purchaser. The purchaser, at the time he buys the article, makes a down payment in the form of cash or a trade-in to the dealer and at the same time agrees to make a certain number of equal monthly installments to the financing institution. The dealer thereupon delivers the article to the buyer and the financing institution's contract signed by the purchaser is delivered to the financing institution which collects it. The total price contained in the contract is a "deferred time balance," which will usually include the cash sale price of the article sold, charges for taxes and insurance, and a financing service charge. By agreement between the dealer and the financing institution, the dealer receives an advance from the financing institution of a major portion of the invoice price of the article sold. Taxes and insurance are usually paid at the time of sale and the manner of handling these payments is not important for our purposes. The remaining amount of the purchaser's total obligation, set forth in the contract, is reflected on the books

of the financing institution, the dealer and the purchaser by a series of accounting entries.

A. Financing Institution Procedure

The financing institution establishes on its books a deferred income account for that portion of the finance charge which it may earn and an account reflecting the return of principal. The amounts received by the financing institution from the purchaser are each apportioned between a return of principal and a payment of the finance charge as payments are made on the contract, and the finance charge is not taken into income by the financing institution until such time as each increment is paid by the purchaser.

The remaining amount of the purchaser's obligation, which has not been credited to the deferred income account of the financing institution, is credited to a "dealer's reserve account" on the financing institution's books. The amounts credited to this account consist of a portion of the cash sale price of the article sold (for example—5%), which the financing institution refuses to advance, and a portion of the finance charge which financing institution will share with the dealer if the financing charge is earned. If the purchaser should prepay the contract or default on his payments, then the contract financing charge will not be earned and the financing institution will have no finance charge to share with the dealer. Similarly, in case of default the financing institution will not advance or pay to the dealer the remainder of the invoice price.

The agreement between the financing institution and

the dealer is a general one and covers a large number of separate transactions with many individual purchasers. One of the terms of this agreement is that no amounts will be made available by the financing institution to the dealer from this "dealer reserve account" until such time as the amounts credited by the financing institution to the "dealer's reserve account" exceed a certain percentage of the total amount of contracts which the dealer and financing institution have entered into with respect to purchasers buying articles from the dealer. The amount of this percentage may vary, and sometimes is in the complete discretion of the financing institution, but in no case is the financing institution obligated to make available to the dealer any amounts whether credited to the "dealer reserve account" or not until the terms of the agreement between the parties have been met.

B. Dealer Procedure

The accrual accounting system of the dealer for this same transaction has a sales account in which is reflected the money which the dealer receives as cash or trade-in from the purchaser, plus the amount advanced by the financing institution to the purchaser to finance the sale. The amount received from the financing institution is the invoice price of the article less a portion of the invoice price which the financing institution refuses to advance. In the event 5% was not advanced the dealer would receive 95% of the cash sale price. The additional amounts to which the dealer may later become entitled, which would be the 5% of the cash sale price, plus a portion of the finance charge, are either not re-

corded at all by the dealer, or are recorded on a memorandum record kept for information purposes. These amounts will never be received unless the financing institution not only collects the full contract balance from the purchaser but also won't be received unless the financing institution has collected the amounts from other purchasers to secure itself against losses provided for in the general agreement between financing institution and dealer. In the event that the financing institution should make available to the dealer some amounts from the reserve account which it has established on its books, the dealer at that time takes these amounts into income.

C. Purchaser Procedure

The purchaser, if on an accrual basis, at the time he obtains the article and signs the deferred balance contract enters the value of the article as an asset and the contract as a liability on his balance sheet. The amount owing as a finance charge is not deducted as an expense by the purchaser at the time of the signing of the contract, but is deducted each year as it becomes due and payable under the contract.

STATUTES INVOLVED

The statutes involved are Sections 41 and 42a of the Internal Revenue Code of 1939. These sections are set forth at length in IA of the Argument.

ARGUMENT

I.

The Accrual Accounting System of the Taxpayer Properly Reflects the Income Received by Taxpayer in His Business and To Be Required to Change to the Artificial Position Demanded by the Commissioner Would Destroy the Taxpayer's Business

A. The Taxpayer's Accrual Accounting System Properly Reflects Net Taxable Income as Required by the Internal Revenue Code as Interpreted by the United States Supreme Court

The fundamental problem involved concerning the taxation of the so-called credits to "dealer reserves" is to determine the point in time when the dealer has received income on which federal income tax must be paid. The Internal Revenue Code of 1939 succinctly covered this situation in two sections—41 and 42(a)—which provided as follows:

> "SEC. 41. GENERAL RULE.
>
> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. . . . "
>
> "SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.
>
> "(a) General Rule—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the tax-

payer, unless, under methods of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period. . . . ''

The principles embodied in the above-cited sections have been carried over without any basic change into the Internal Revenue Code of 1954 as Secs. 441, 446 and 451.

All taxpayers, concerned with this ''dealer reserve issue,'' are required to keep their books on an accrual accounting basis because they maintain inventories. I.R.C. (1939) §22(c). Treasury Reg. 111, §29.41-2, followed by Reg. 118, §39.41-2.

It is clear from the above-cited statutes that a starting point of any issue involving the taxpayer's method of reporting his income is that taxpayer should report in accordance with the method of accounting regularly employed in keeping his books. The taxpayer in this case has done so.

This method should be upset only if the method employed does not clearly reflect the income of the taxpayer, in which case the Commissioner has the right to designate a method which does clearly reflect income. This fundamental requirement of a clear reflection of income means that the taxpayer's business must be examined to determine its actual mechanical workings and then the taxpayer's method of accounting for his business transactions must be compared with the taxpayer's business to determine whether the taxpayer's accounting system clearly reflects income, or, if it does not, whether the Commissioner has a system which does clearly reflect income.

Two United States Supreme Court opinions many years ago established the basic tests which an accrual accounting system must pass in order clearly to reflect income. The case of *North American Oil Consolidated v. Burnett,* 286 U.S. 417, 424, 76 L.Ed. 1197, 1200, established the concept of income being reportable when the taxpayer receives earnings under a "claim of right."

This case was followed the next year by *Spring City Foundry Co. v. Comm.,* 292 U.S. 182, 78 L.Ed. 1200, which established that it is the "right to receive" and not the actual receipt of income that determines its inclusion in gross income when using the accrual accounting system.

This principle must not be artificially applied, and the respondent Commissioner in other cases takes the position that substance, not form, must govern. This view has been followed on this issue by the Appellate Courts. As was stated by the Fourth Circuit in *Blaine, Johnson v. Comm.,* 233 F.(2d) 952 (4th Cir. 1956), when commenting on this "dealer reserve" taxation at page 957:

> "Taxation is a practical matter; the substance of what is done and not the form must govern."

When we examine the substance of the transactions involved in these cases, we find that the sale of automobiles or house trailers is not like selling a house in that the items are very mobile and the purchasers are of relatively insecure financial status. The elements of risk and the volume of financing required limit the market for normal financing of the commercial paper involved in these sales and create the necessity for specialized

financing arrangements. In many cases, this has caused the creation of specialized financing institutions, such as General Motors Acceptance Corporation and Universal C.I.T. These institutions operate almost exclusively in financing these operations.

An examination of these sales reveals that they are three-cornered transactions involving a dealer, a purchaser, and a financing institution, all of whom are necessary before the article can be sold. The degree of control by the financing institution over the transaction varies from case to case, usually depending upon the financial strength of the dealer and his ability to bargain with the financing institution. In all cases, however, the financing institution exercises a degree of control over the dealer and is considered in the transaction from the beginning. As can be seen from the facts that in this case (and in general practice) the original contract is made on the financing institution's form, and at all times the parties involved recognize that the purchaser will make payments directly to the financing institution.

The contract signed by the purchaser provides that the purchaser will make a series of equal monthly payments to the financing institution, each of which contains a partial payment on the purchase price and a partial payment on the financing charge. The financing institution, as it receives these payments, credits part to principal and part to its income account. The financing institution pays income tax on the purchaser's contract only as it receives the payments from the purchaser, since there is no "right to receive" any finance charges

from the purchaser in the event that the purchaser prepays the contract or the item is repossessed. *Motor Securities Co., Inc.,* Par. 52,316 P-H Memo, T.C.

The dealer in this transaction receives from the purchaser a partial down payment on the merchandise and receives from the finance company a partial payment on the remaining balance due on the purchase price of the merchandise. The dealer does not receive the full value of the merchandise sold because the financing institution refuses to advance a portion of the purchase price which, on the financing institution's books, is credited to the "dealer's reserve account." In addition to this amount not advanced to the dealer, the financing institution will generally agree with the dealer (depending upon the bargaining power of the dealer and the respective financing institution) to pay to the dealer a portion of the finance charge to be collected from the purchaser in the event that said financing charge is fully collected. An amount representing the dealer's share of the anticipated profits, if collected, is also credited to the "dealer's reserve account" on the financing company's books at the time the company first receives the contract from the purchaser. Whether or not the dealer actually receives *anything* from the financing institution sometimes is solely in the discretion of the financing institution, and other times depends upon the credits to the dealer on the financing institution's books to his "dealer reserve account" exceeding a certain arbitrary figure. This "dealer reserve account" may never reach this figure because this reserve account is reduced on the financing institution's books whenever the finance charge is not

collected from the purchaser or the financing institution suffers a loss on the financing developed through the particular dealer.

The taxpayer's accounting system reflects income from the financing institution when the dealer has amounts made available to him by the financing institution. This is completely proper and the only method which clearly reflects the taxpayer's income because in no case does the dealer have a "right to receive" or "claim of right" to any funds in the hands of the financing institution until the purchaser pays the financing institution and, by the requirements of the agreement between the dealer and the financing institution, there is an obligation by the financing institution to the dealer. In none of the cases involving these credits to the "dealer's reserve" does the dealer have any right to any amounts in the hands of the financing institution simply because they are credited to a "dealer reserve account" and the Commissioner has in no case demonstrated any right which the taxpayer has to such funds which should cause the taxpayer to be required to change his system of accounting in order to more "clearly reflect income."

B. To Follow the Commissioner's Requirements Would Distort the Accounting System and Not Clearly Reflect the Income Derived from the Transaction

The Commissioner's position (as shown by his recent argument in *Texas Trailer Coach, Inc., v. Comm.,* 1 A.F.T.R.2d 58-533) is that there are two separate transactions in the sale of the merchandise and that the credit by the financing company to a "dealer reserve

account'' on the financing institution's books is income to the dealer which must be accrued at the time such entry is made. This is a theoretical analysis which does not reflect the realities of the business transaction, nor the rights of the respective parties. If the taxpayer-dealer were to follow this system, he would be creating income before it came into existence, since the dealer has no claim of right and, in fact, no claim at all to any of the ''dealer reserve account'' until the purchaser has paid and the financing institution's requirements with respect to the dealer have been completed. The financing institution itself is not required to take these into income until the purchaser makes payments. *Motor Securities Co., Inc., supra.*

Only recently in the field of ''patronage refund credits'' the Court of Appeals for the Fourth Circuit held that a taxpayer on the accrual basis did not receive income through the crediting of a patronage refund credit to his account on the books of a cooperative where such credit was subject to diminution because of various contingencies contained in the agreement between the taxpayer and the cooperative. *Long Poultry Farms v. Comm.,* 249 F.2d 726 (C.A. 4th, 1957). The Internal Revenue Service has now announced that it will follow the court decisions culminating in *Long Poultry Farms, supra.* See Rev. Rul. 57-358, IRB. 1957-32 Par. 54,503 P-H Fed. Tax Ser. (1958). The issue involved in that case is almost identical to the situation at bar.

The taxpayer-dealer does not have a right to receive anything from the financing institution until the conditions of the agreement have been met. The dealers in

many cases have the duty of serving the contracts, completing repossessions, and handling other complaints of the purchaser. In a very similar situation, the Tax Court, in the case of commission accruals to an insurance company's general agent's account, held that the agent was not taxable on such credits until the credits were subject to petitioner's unrestricted use and enjoyment. *Leedy-Glover Realty & Insurance Co.,* 13 T.C. 95, 106 (1949). In that case the agent's commissions were in existence and were placed in escrow pending the passage of time until the premium had been paid for each year and the serving required by the agent had been completed. This goes far beyond the case at bar where the moneys are not yet even in existence, so far as the purchaser's making payments on the contract are concerned.

C. To Ignore the Realities of the Business Transaction and Distort This Type of Accounting System Can Destroy the Businesses of Many Small Growing Dealers

The distortion of reporting income, requested by Commissioner, is not merely a shifting of income from one year to another with harmless over-all effect. Instead, the shifting of income sought by Commissioner makes it impossible for small expanding businesses to pay their taxes. Hence, the issue is of grave importance to many taxpayers.

A simple example of what the effect is follows: Assume a taxpayer starts in the automobile or trailer sales business in 1948 with a capital of $25,000 and that after paying the necessary fixed expenses of the business he has $20,000 available for financing his inven-

tory. With this he purchases ten $2,000 automobiles which sell for $2,500 and on which, if sold on a three-year contract, there would be a $500 finance charge, leaving the purchaser with a $3,000 contract. Placing this in chart form the following is apparent by using Commissioner's position:

Contract Price	$3,000.00
Finance Charge	500.00
Car Price	2,500.00
Cost	2,000.00
Gross Profit	500.00
Selling Expenses	300.00
Net Profit If Received $2500.00	200.00
Taxes (30% on $200)	60.00
Profit After Tax	140.00
Not Advanced by Finance Co.— 5% of $2,500	125.00
Return to Dealer	15.00
Tax on Reserve (30% tax on $100 split to dealer of finance charge)	30.00
Net Cash Loss on Each Transaction	(15.00)

By projecting this cash loss in each transaction the following is apparent:

	1948 (250 cars sold)	1949 (500 cars sold)	1950 (1000 cars sold)
Net cash loss	($3,750.00)	($ 7,500.00)	($15,000.00)
Cumulative cash deficit	($3,750.00)	($11,250.00)	($26,250.00)

It is undisputed the dealer is not entitled to any of the unadvanced amounts held by the finance company, nor any splitting of the finance charge until such time as the dealer's reserve has exceeded a certain percentage of the total contracts being held by the financing institution. Most of these contracts run two or three years, and as long as business increases there is no return at all. It is readily apparent that the dealer suffers a net cash loss of $15.00 each time an automobile is sold if he pays tax on money he has no right to receive. Assuming his business increases each year (which is the pattern of this business), the first year he has a $3,750 cash deficit, which means he has no funds to continue his inventory at ten cars. The next year he has a $11,250.00 cash deficit. The third year he has a $26,250 cash deficit. This means that before the third year has been completed his capital of $20,000 has been more than completely wiped out, he has been unable to pay his taxes and is out of business. The dealer is not entitled to share in the finance charge until such time as the contract has been paid out (usually two to three years), and he has in the reserve account an amount in excess of a certain percentage of the contracts held by the financing company (which he cannot do, since the number of contracts is going up each year and he never arrives at the percentage). We find that the dealer is soon taxed out of existence. The reason for this result is the imposition of a tax on items which the dealer has no right to receive and cannot even consider an asset for the purpose of borrowing or otherwise strengthening his cash position. In the field of trailer sales this situation is even more difficult, since the contracts run for longer periods (five

to seven years), which means that the dealer does not receive any payments from the financing institution for as long as five to seven years and in the meantime, using the Commissioner's argument, a tax bill of tremendous proportion has built up on these funds which are not available to him. As can be seen from the example, the dealer could only pay $15 toward the $30 owing because of taxes on the reserve, and $125 not available, so penalties and interest also are incurred.

These principles have been well stated by the various courts of appeal in reversing the Tax Court. The case of *Long Poultry Farms v. Commissioner,* 249 F.(2d) 726, 730 (C.A. 4th 1957), involving patronage refunds, is a recent pronouncement of a court of appeal on this subject of taxing credits. That case holds these credits not taxable when credited and quotes from *Johnson v. Commissioner,* 233 F.(2d) 952 (C.A. 4th 1956), in which the court, in deciding the precise issue before this court, held that sums withheld by a financing institution for amounts due taxpayer and credited to him on a reserve account were not taxable to the taxpayer until the year in which the right to receive them became fixed.

The taxpayer-dealer in these cases may never receive the income on which he has paid tax. Since he has no fixed right to receive anything in the year in which amounts are credited to an account on the financing institution's books to tax him on these credits will, in a short period, destroy the taxpayer's business by completely depleting his working capital and imposing on him penalties and interest for taxes he simply cannot obtain the funds to pay.

II.

The Courts Other Than the Tax Court Generally Hold That the Taxpayer Should Not Be Taxed on Credits to a Dealer's Reserve Until the Funds Are Available to Him Under the Terms of His Agreement with the Financing Institution

There is no question in these "dealer reserve" cases that the dealer will be taxed on the amount which he receives as income. The question is one of whether the dealer will be taxed on an artificial concept of income which may or may not ever become income in fact.

A. The Courts of Appeals Have Uniformly Held Taxpayers Not Taxable on Credits to the Reserve

The principle of the non-taxability of these "dealer reserves" was long ago established by the Third Circuit in *Keasbey & Mattison Co. v. U. S.*, 141 F.(2d) 163 (3rd Cir. 1944).

There are several recent Court of Appeals opinions on this issue which have followed *Keasey & Mattison Co. v. U. S., supra,* and have rejected the Commissioner's attempts to tax the dealers on the "dealer reserve account" credits.

Johnson v. Comm., 233 F.(2d) 952 (4th Cir. 1956);

Texas Trailer Coach, Inc., v. Comm., 1 A.F.T.R.2d 58-533 (5th Cir. 1957);

West Pontiac, Inc., v. Comm., 1 A.F.T.R.2d 58-839 (5th Cir. 1957).

All of the above cases hold that "dealer reserve" credits are not taxable to the dealer at the time the credit is made on the financing institution's books.

The issue is presently pending before the following circuits in the following cases:

Schaeffer v. Comm., 6th Cir. No. 13421—argued April 10, 1958;

Baird v. Comm., 7th Cir. No. 12230—set for argument April 24, 1958;

Glover v. Comm., 8th Cir. No. 15877—argued March 7, 1958;

Hansen v. Comm., 9th Cir. No. 15821—set for argument May 13, 1958.

In addition to the above-listed cases, the following cases have been decided adversely to the taxpayer in the Tax Court and may, by the date of this brief, also be on appeal:

Albert M. Brodsky, 27 T.C. 216, decided October 17, 1957 (9th Cir.);

Arthur Morgan, 29 T.C. No. 9, decided October 17, 1957 (9th Cir.);

Charles M. Kilborn, 29 T.C. No. 14, decided October 24, 1957 (5th Cir.);

Vance L. Wiley, Par. 57,236 P-H Memo T.C., decided December 23, 1957 (6th Cir.).

The most recent Court of Appeals opinion analyzing this issue is *Texas Trailer Coach, Inc., v. Comm., supra,* in which the court makes a very detailed analysis of the pattern of these transactions and the authorities and concludes as follows:

> "This case shakes down to a few basic facts. In each credit sale of a trailer, the obligations of the purchaser, dealer and finance company were inextricably interwoven in a single three-party agreement. The agreement gave the finance com-

pany virtually complete control over 5% of the unpaid purchase price. The finance company exercised its control by withholding this 5% in a special dealer's reserve account surrounded by various conditions precedent to payment. These conditions were contingencies which might have barred indefinitely the dealer's receipt of payments or right to receive payments from the account. One of these contingencies, the proviso that the account exceeds 15% of the unpaid balance on all trailer contracts effectively barred the dealer from receiving or having the right to receive any amounts from the reserve account until nearly the end of the third year of the dealer's corporate existence. We hold, therefore, without generalizing beyond the logical necessities inherent in the facts of this case, that the amounts in this dealer's reserve account were contingent credits. They did not accrue in the taxable year when the finance company withheld the amounts and credited them on its books to the taxpayer."

B. The United States District Courts Have Uniformly Held Taxpayers Not Taxable on Credits to Such Reserve Accounts

The United States District Courts which have recently considered this matter have uniformly held that "dealer reserves" are not taxable to the dealer until payments are received from him. It is not believed that the Commissioner has appealed any of these cases.

Massey Motors, Inc., v. U. S., 156 F.Supp. 516, 157 P-H P 72,989 (D.C. Fla., Oct. 7, 1957, amended Nov. 6, 1957);

Modern Olds, Inc., v. U. S., ... F.Supp. ....., 1 A.F.T.R.2d 58-732 (N.D. Tex., Dec. 17, 1957);

Hines Pontiac v. U. S., ... F.Supp. ....., 1 A.F.T.R.2d 58-734 (N.D. Tex., Dec. 18, 1957).

C. The Position of the Commissioner and the Tax Court Is Inconsistent with Good Accounting Principles and with the Treatment Accorded to the Other Taxpayers Involved in the Transaction

The first examination of these "dealer reserve accounts" in the Tax Court appears in *Shoemaker-Nash, Inc., v. Comm.,* 41 B.T. 417 (Feb. 16, 1940), wherein the court held that reserves credited to the account of the taxpayer on the financing institution's books were really of benefit to the taxpayer since they stood in place of an otherwise direct charge. In less than a year, however, the Tax Court in *Ernest G. Beaudry* (Feb. 14, 1941) distinguished the *Shoemaker-Nash* case and held that credits to a "dealer reserve account" by a financing institution were not taxable to the dealer when the amounts in the account were required to exceed 7½% of the total contracts outstanding between dealer and the financing institution before the financing institution was obligated to pay over any amounts to the dealer. The *Beaudry* decision seems to have been forgotten by the Tax Court in its recent series of decisions holding credits to these accounts to be taxable to the dealer.

The position of the Tax Court and Commissioner is inconsistent with the treatment accorded the financing institution by the Tax Court, which, in *Motor Securities, Inc.,* PP 52,316 P-H Memo T.C., holds that the amounts credited by the financing institution to its deferred income account, which arise from the same transaction and are the ultimate proceeds from which the

financing institution and dealer will be paid, are not taxable to the financing institution until such payments are received from the purchaser.

The purchaser, who is the third party to this transaction, is probably not allowed to accrue the expense of the finance charge until the payment becomes due under the terms of the contract. I.T. 3740, 1945 C.B., p. 109; see also *Security Flour Mills Company v. Comm.,* 321 U.S. 281, 88 L.Ed. 725. This taxation of the purchaser is consistent with the taxation of the financing institution which does not take these amounts into income until paid and is consistent with the position urged by the taxpayer herein. The Commissioner's taxation of the dealer on these reserves is inconsistent with the taxing of the other parties to the transaction.

D. The Established Accounting System of the Industry Properly Reflects Income and Should Not Be Distorted

The desirability of following the established system of accounting widely used by an industry which properly reflects the business realities of the transactions has been recently set forth by this court in the case of *Pacific Grape Prod. Co. v. Comm.,* 219 F.(2d) 862 (9th Cir. 1955), wherein Judge Pope states at page 869:

> "Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not re-

flect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

See also the dissenting opinion of Judge Opper of the Tax Court quoted in footnote 10 of the opinion.

III.
CONCLUSION

Taxpayers selling tangible merchandise on a deferred payment basis should not be taxed when their financing institution credits certain amounts to an account entitled "dealer reserve account" over which the taxpayer has no control and from which he is not entitled to any proceeds. Taxpayers should be taxed on these amounts only when they become available to them in accordance with the agreement between them and the financing institution.

Respectfully submitted,

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No. 15,823

United States Court of Appeals
For the Ninth Circuit

ERIC SOBY, d/b/a SOBY PAINTING CO., and UNITED STATES FIDELITY AND GUARANTY COMPANY, *Appellants*

vs.

LLOYD W. JOHNSON and MAX J. KUNEY, d/b/a KUNEY JOHNSON COMPANY, *Appellees.*

APPEAL FROM THE DISTRICT COURT FOR THE DISTRICT OF ALASKA, THIRD DIVISION

THE HONORABLE J. L. McCARREY, JR.
United States District Judge

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BRIEF OF APPELLEES

JURISDICTION

There is no issue as to either the jurisdiction of the District Court or of this court, and appellees accept the appellants' statement as to jurisdiction contained on pages 1 and 2 in appellants' brief.

STATEMENT OF THE CASE

Appellees are unable to accept appellants' statement of the case.

In October and November, 1952, appellees entered into two construction contracts with the United States of America. Contract No. DA-95-507-eng-384 was for construction of 14 buildings, each providing for 8 family

units, or a total of 112 apartments at Ladd Air Force Base, Fairbanks, Alaska (Ex. 1). Contract No. DA-95-507-eng-385 was for the construction of 5 three-story airmen dormitory buildings and 1 one-story mess and administration combination building at Eielson Air Force Base, Fairbanks, Alaska (Ex. 2).[1]

Appellant Eric Soby entered into subcontracts with appellees to furnish all labor, material, equipment and services required to perform the taping and spackling of the sheet rock and the painting required on both of the prime contracts. Soby's contract price on the Ladd contract was $109,113.00 and on the Eielson installations subcontract earnings at completion were $78,-336.90, including the extra work (Exs. 13 (1 and 2), II).

The appellant United States Fidelity and Guaranty Company[2] was surety for Soby under both of his contracts (Exs. A, B).

Soby commenced performance under his two subcontracts in the spring of 1953. Although he was an experienced painter he had not previously undertaken contracts as large as the subcontracts herein. Soby was confronted with labor problems on these contracts on at least three occasions and with a complete lack of adequate and competent supervision in the performance of his subcontract at Ladd, resulting in poor workmanship and the subsequent rejection of his work by the government inspectors in the fall of 1953 (Tr. 90, 91).

[1] Throughout the trial the Ladd contract was referred to as "384" and the Eielson contract as "385." Such designations will be used herein, or alternately "Ladd" and "Eielson."

[2] Hereafter referred to as "U. S. F. & G."

In November, 1953, appellees were compelled to advance funds to Soby so he could meet his payrolls, which advances were approved in writing by U. S. F. & G. (Tr. 91, Ex. EE).

When none of the buildings on the Ladd project were completed to the satisfaction of the government,[3] two representatives of U. S. F. & G. inspected the Ladd and Eielson projects in December, 1953. Thereafter, on December 10, 1953, appellees were assured that competent help would be obtained to complete the subcontracts to the satisfaction of the government (Tr. 91). However, during their inspection trip, representatives of U. S. F. & G. contacted other painters in Fairbanks in an effort to determine how much it would cost to finish the work (Tr. 58, 1271).

Subsequent thereto, without consulting the appellees and without their knowledge, one of the representatives of U. S. F. & G. ordered and directed Soby to cease work on both the Ladd and Eielson projects, whereupon he wilfully and voluntarily abandoned both contracts on December 19, 1953 (Tr. 61, 92, 1441, 1442). The District Court's Finding of Fact in this regard is not an issue on this appeal (Tr. 92).

Mr. Murray, a U. S. F. & G. representative, admitted to the appellee Lloyd Johnson that he had changed his mind on keeping Soby on the job, and requested that appellees obtain a competent painting contractor to complete the work, but asked that the new painter not start until after the pending Christmas holidays (Tr.

[3] As required by appellees' contracts 384 and 385 with the government (Exs. 1(1), 2(1).)

59, 1443). This conversation was confirmed by a letter to Kuney Johnson Company from Mr. Murray dated December 23, 1953, in which he stated:

> "Mr. Johnson in a telephone conversation with the writer at Fairbanks tendered the completion of the contracts to the U. S. F. & G., and this letter is to confirm such tender and also our regretful inability to accept the tender. Therefore, this leaves you free and without prejudice to complete the contracts and to tender to us the claim of the cost of the completion over and above the contract prices involved." (Ex. DD, Tr. 1443).

Representatives of U. S. F. & G. and the appellees held a conference on December 29, 1953, following which there was an immediate exchange of letters and in U. S. F. & G.'s letter dated December 31, 1953, the employment of Harold Larsen, d/b/a Larsen Brothers Painting Co., to complete the painting subcontracts in accordance with appellees' proposal, was expressly approved (Exs. J, J(a)). Larsen's superintendent was one of the painting contractors interviewed by the U. S. F. & G. representatives on their inspection trip in December, 1953 (Tr. 1271).

Larsen commenced work January 4, 1954 (Ex. 36) and entered into a written contract to complete the painting, taping and spackling work required to obtain government acceptance of the projects. Larsen was to be compensated for his actual labor and material costs, plus a fee of 10% of the labor cost only (Ex. C). This percentage was not computed on the cost of materials and no overhead or profit was charged to Soby for the benefit of appellees (Ex. C, Tr. 1510). The damages

awarded appellees for the cost of completing Soby's unfinished work were solely direct field costs and interest thereon (Tr. 1511, Ex. II).

By his Amended Complaint Soby sought damages not upon his subcontracts, but upon the theory of *quantum meruit* (Tr. 26, 477), claiming his work had been damaged by appellees using improper materials on the Ladd project (no such claim was made with reference to the Eielson project). This issue was decided in appellees' favor and is not now challenged on this appeal.

The Appellees' Second Amended Answer and Cross-Complaint is an action for breach of contract seeking damages because of the costs expended in completing Soby's unfinished work (Tr. 34). The Second Affirmative Defense and Cross-Complaint therein (Tr. 38) is the only pleading material to the first issue raised by appellants,[4] wherein appellants challenge the amount found to have been expended to complete Soby's unfinished work on the Eielson contract (Tr. 38). The District Court found that appellees' damages were amply supported by the evidence (Tr. 94), and were documented by payroll records, invoices, government inspectors' reports, and correspondence, all of which were admitted without objection. The judgment was for the exact amount prayed for by appellees, which amount was fully ascertained prior to the commencement of the trial, and which amount was readily available and known to appellants because weekly invoices were mailed to both Soby and U. S. F. & G. as the expenditures were made (Ex. F, Tr. 1505).

[4] Appellants' Brief, page 21, hereafter abbreviated "App. Br."

When Soby abandoned his contracts he voluntarily left supplies, materials and equipment at the respective job sites. These items were used by appellees in an endeavor to reduce costs, as the same items would have been purchased by Larsen Brothers Painting Co. had Soby removed them (Tr. 1515). At the completion of the work in the spring of 1954, the remaining items were tendered to Soby (Ex. CC). The tender was not accepted and appellees sold the items to another painting contractor for $616.00, which sum was credited to Soby (Ex. II, Tr. 45).

Appellants' Statement of Points covered almost every facet of the litigation and necessitated the printing of this record totaling 1815 pages, the greater portion of which related to the issues raised by Soby's Amended Complaint.

By the Statement of Issues presented and Specification of Errors in their brief, pages 18 to 20 inclusive, appellants have abandoned their appeal from that portion of the Judgment of the District Court denying recovery to Soby and have abandoned their appeal as to appellees' Judgment relating to the cost of completing the job at Ladd. Therefore, a major portion of the Transcript of Record is immaterial.

This appeal relates solely to appellees' Judgment for the cost of completing appellant Soby's work at Eielson; interest allowed appellees upon both cross-complaints from September 1, 1956, to the date of judgment; and the matter of the $3,000.00 offset which the District Court allowed for Soby's inventory.

SUMMARY OF ARGUMENT

Upon Soby's wilful and voluntary abandonment of his subcontracts, appellees were required to complete the unfinished work at Eielson to the satisfaction of the government, and as a result thereof appellants are liable for the necessary expenditures, which were established in every detail.

Appellees are entitled to recover the costs of completing the unfinished work to the satisfaction of the government as a result of Soby's abandonment.

All of appellees' costs were necessary expenditures, which were substantiated in detail.

Appellants were unable to rebut the accuracy of the completion costs, although they had ample opportunity to do so.

Appellants' inferences of "featherbedding and collusion" predicated upon a government percentage of completion estimate (Ex. 46(2)) are without substance, and appellants' computations in support of such inferences are incorrect.

Appellees' reasonable costs expended in completing the unfinished work, following Soby's abandonment, were not only liquidated but ascertainable as soon as such costs were incurred, and the District Court did not err in awarding interest on such sums.

The $3,000.00 inventory credit allowed by the District Court (increasing the credit allowed Soby by appellees from the figure of $616.00) was well within the evidence.

ARGUMENT

1. Upon Soby's Wilful and Voluntary Abandonment of His Subcontracts, Appellees Were Required to Complete the Unfinished Work at Eielson to the Satisfaction of the Government, and as a Result Thereof Appellants Are Liable for the Necessary Expenditures, Which Were Established in Every Detail.

(a) ***Appellees are entitled to recover the costs of completing the unfinished work to the satisfaction of the government as a result of Soby's abandonment.***

Appellants' brief expressly concedes that Soby wilfully abandoned his subcontracts without cause.[5]

Appellee's damages are measured by the actual loss incurred as a natural and proximate consequence of the unjustified abandonment, which in this case is the sum appellees were compelled to pay the Larsen Brothers Painting Company, plus their own added field costs, to complete the unfinished painting subcontracts.

In *United States v. Behan,* 110 U.S. 338, 28 L.ed. 168, 4 S.Ct. 81 (1884), it was found that the government had wrongfully terminated a construction contract. The Supreme Court held the measure of damages for the breach of contract was the amount of the loss and expenditures which the injured contractor had sustained in the fair endeavor to perform his contract. The court further held that if such expenditures were foolishly and unreasonably incurred, it must be proved by the party making such allegations, as such matters are not to be presumed.

In 25 C.J.S., Sec. 79, p. 580, "Damages," the rule is stated as follows:

[5] (App. Br. p. 27).

> "The damages for failure to furnish labor or services in accordance with a contract therefor are measured by the actual loss sustained as a natural and proximate consequence, which, when the contract is to perform a specific piece of work or service, is ordinarily the reasonable cost of securing performance by other means. . . . "

In *Associated Lathing and Plaster Co. v. Louis C. Dunn, Inc.,* 135 Cal.App.(2d) 40, 286 P.(2d) 825 (1955), it was held that a general contractor was entitled to recover as damages the difference between the price for which the subcontractor agreed to do the work and the reasonable cost of completing the job by the second lowest bidder.

See also *American Can Co. v. Garnett,* 279 Fed. 722, 727 (9th Cir. 1922), wherein the court stated:

> "The defendant having wrongfully put an end to the contract and, having prevented the plaintiff from performing it, is estopped to deny that the latter is damaged to the extent of his actual loss and outlay fairly incurred,"

citing *United States v. Behan, supra.*

(b) ***All of appellees' costs were necessary expenditures, which were substantiated in detail.***

The District Court made an express finding that appellees had properly expended the reasonable sum of $53,955.43 (which included interest to September 1, 1956) to complete the Eielson contract (Tr. 94).

In the District Court's oral opinion, it mentioned the fact that all payrolls and other expenses of the Larsen Brothers Painting Company were supported by can-

celled checks, invoices and correspondence (Tr. 68). The exhibits establishing appellees' damages were admitted into evidence without objection. They are as follows:

Exhibit C—Larsen invoices (Tr. 22).

Exhibit D—Larsen's foremen's time cards (Tr. 22).

Exhibit E—Larsen and Kuney Johnson's payrolls December 28, 1953 to June 26, 1954 (Tr. 22).

Exhibit F—Kuney Johnson invoices to Soby Painting Company November 10, 1953 to April 30, 1954 (Tr. 22).

Exhibit G—Kuney Johnson check vouchers November 16, 1953 to March 4, 1954 (Tr. 22).

Exhibit H—Requisition book showing material purchases during Larsen's performance (Tr. 22).

Exhibit I—Including interest paid to April 30, 1954.

Exhibit II — Itemization of appellees' cross-complaints (Tr. 1505).

Exhibit JJ—Detailed proof and analysis of cross-complaints (Tr. 1511).

Exhibit 36—Inspectors' daily reports showing work performed each day by Larsen Brothers Painting Company (Tr. 23).

Harold Larsen testified that his contract with appellees was entirely reasonable (Tr. 903), that his objective was to clean the job up as cheaply and reasonably as possible (Tr. 943).

Tom Corbett, superintendent for Larsen, and Harold

Stenson, general superintendent for appellees, both testified that all of the work performed by the Larsen Brothers Painting Company was necessary to complete the Eielson project (Tr. 1280, 1136).

Max J. Kuney testified that he instructed his Alaska office to bill Soby Painting Company actual direct field costs, without overhead, without profit and without markup. This was done and each week a statement was mailed to each of appellants (Tr. 1504-1505, Ex. F).

It is difficult to understand how proof of damages such as those contained in appellees' second cross-complaint could have been more detailed. The same method of proof, and in fact the same testimony and exhibits, established appellees' first cross-complaint, and the Judgment of the District Court awarded thereon, from which no appeal has been taken.

(c) ***Appellants were unable to rebut the accuracy of the completion costs, although they had ample opportunity to do so.***

Appellants offered no rebuttal testimony to refute appellees' proof of the work required subsequent to January 1, 1954 to complete the painting subcontract on the Eielson project to the satisfaction of the government. Had appellees' proof not been completely accurate, appellants could have offered rebuttal evidence. Soby, his superintendents, and government personnel, all had actual knowledge of the job progress, as did Mr. Douglas, the representative of U. S. F. & G., who investigated Soby's work in December, 1953, and Victor C. Rivers, the professional engineer, who investigated

the Ladd and Eielson projects in February, 1954, upon behalf of Soby (Tr. 1636). The irrefutable conclusion is that appellees' evidence was completely accurate.

As stated in *United States v. Behan, supra,* a contention that expenditures to complete a contract are unreasonable must be proved, as such matters will not be presumed. Appellees do not deem it necessary to cite any authority for the proposition that allegations of fraud must be pleaded and cannot be raised for the first time on appeal.

In *Elias v. Wright,* 276 Fed. 908 (2d Cir., 1921), a general contractor was awarded judgment against a subcontractor for failing to perform. The court held that the general contractor was entitled to recover such reasonable sum expended for the purchase of material and services necessary for the completion of the subcontractor's work, or as is sometimes stated, the difference between the contract price and the actual price of completion of the work required. As to the percentage of overhead the general contractor was entitled to recover, the court stated in affirming the award made, that the subcontractor had the opportunity at the trial to refute, either with testimony or cross-examination, that such a charge was unreasonable.

For a case approving expenditures analogous to those in the instant case, see *Gulf States Creosoting Co. v. Loving,* 120 F.(2d) 195 (4th Cir. 1941).

(d) ***Appellants inferences of "feather-bedding and collusion" predicated upon a government percentage of completion estimate (Ex. 46(2)) are without substance, and appellants' computations in support of such inferences are incorrect.***

Since it is impossible for appellants to attack appellees' testimony in support of damages, they infer more work was done than required and base their sole argument upon an alleged percentage of completion figure as of December 31, 1953 which appears on a government report (Ex. 46(2)). This percentage figure was a government estimate relating to payment schedules and pertained to a heading entitled "Interior Finish," which heading included many other items in addition to painting work required under the Soby subcontract (Tr. 1880).

The record is void as to all of the items included under the term "Interior Finish" on the Eielson project. However, with reference to the Ladd project, the record shows that such item on the government estimate included in addition to painting, hardwood floors, door finishes, doors, milk work, trim, kitchen cabinets, floors and wall coverings, finish hard wood and possibly bathroom accessories (Tr. 1799). Here again, the explanation for the heading "Interior Finish" was given by an employee of appellee and such explanation was never challenged.

Appellants' argument[6] erroneously assumes that the item of "Interior Finish" (Ex. 46(2)) includes only painting, taping and spackling pursuant to the Soby

[6] (App. Br. p. 21).

subcontract. Appellants' argument further erroneously assumes that Soby could have completed the unfinished work on the Eielson project within his contract price. The ultimate erroneous assumption in appellants' argument is that the expenditures found to be necessary by the District Court were actually due to "*outrageous padding, feather-bedding and profiteering, resulting from the collusion of the general contractor and his hand-picked substitute subcontractor, blissfully secure in their knowledge that their platinum-plated performance would come out of the pocket of the appellant, U. S. F. & G., as surety for Soby.*"[7]

Not a single one of the above assumptions is correct.

In addition to appellants' assumptions being wrong, their mathematics are also erroneous.

Appellants allege that "Larsen charged and appellees recovered the sum of approximately $54,000.00, or better than nine times the value of the remaining portion of the contract. . . . "[8] Such an allegation tortures the evidence.

The actual amount paid to Larsen and charged to Soby for Larsen's work was not $54,000.00 as appellants allege but $33,251.06. The total net subcontract costs on the Eielson contract paid by appellees as of August 31, 1956 were $132,292.33 (Ex. II). An examination of the detailed payments and charges as reflected in Exhibits F and I discloses as follows:

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[7] (App. Br. pp. 26, 27).

[8] (App. Br. p. 29).

Amounts paid and billed prior to January 1, 1954	$ 79,448.17	
Miscellaneous items paid or incurred prior to but billed after January 1, 1954	6,382.63	
Cooper's Hardware claim incurred prior to but billed after January 1, 1954	622.01	
TOTAL AMOUNTS INCURRED ON EIELSON BY SOBY PRIOR TO JANUARY 1, 1954		$ 86,452.81
Larsen payroll, taxes and fee	33,251.06	
Miscellaneous materials and expenses after January 1, 1954	1,565.99	
Back charges after January 1, 1954	3,078.36	
TOTAL CHARGES AFTER JANUARY 1, 1954 RESULTING FROM SOBY'S ABANDONMENT		37,895.41
Interest to April 30, 1954	1,363.53	
Interest from April 30, 1954 to August 31, 1956	6,580.58	
TOTAL INTEREST THROUGH AUGUST 31, 1956		7,944.11
TOTAL AMOUNT CHARGED SOBY		132,292.33
Less Total Subcontract Earnings at Completion		78,336.90
APPELLEES' JUDGMENT ON EIELSON CLAIM		$ 53,955.43

Appellees' judgment on the Eielson contract in the amount of $53,955.43 as shown above, does not represent the costs incurred after January 1, 1954 but in fact, as shown on Ex. II, simply represents the difference be-

tween the total charge to Soby ($132,292.33) and the total subcontract earnings to completion ($78,336.90), which included the original subcontract figure, less items deducted from the contract and plus credits given Soby on the N. & A. Cabinet Works account.

Exhibit 46(2), the government progress estimate, does not support appellants' contention that appellees received 73% of the total contract price for completing approximately 8% of the painting contract remaining after Soby left Eielson. This exhibit actually shows $30,552.69 of the painting contract not complete at the time Soby left Eielson. As shown on Ex. 46(2), "Interior Finish" constituted 13.73% of the total prime contract price, which is $346,402.46. This exhibit further shows that on December 31, 1953 there remained incomplete 8.82% of this figure, or $30,552.69. This is 41.48% of the contract price and not approximately 8% as appellants contend.[9]

Max J. Kuney testified fully as to the weight to be given documents such as exhibits 46(1) and 46(2) (Tr. 1554-1562). While appellants now endeavor to ridicule Mr. Kuney's testimony,[10] it is significant that they closed their case without calling any witnesses to refute this testimony. The District Court commented on this omission during the closing arguments (Tr. 1739).

[9] While "Interior Finish" as previously pointed out, includes items other than painting, it is equally obvious that when less than 10% of "Interior Finish" remains to be completed the incomplete portion is substantially all painting (Tr. 999).

[10] Throughout the trial, and in the present brief, appellants deal very recklessly with figures. For example, at page 27 of their brief they argue that the difference between 95% and 97.85% is quibbling, although the percentage difference refers to $2,176,558.01 and amounts to $62,031.90.

The accuracy of work progress payments was questioned in *Noble v. Stephens,* 108 F.Supp. 217 (D.C. Alaska, 1st Div. 1952) wherein the court ruled against a contractor and a surety, and made short work of the contractor's claim that the cost to finish the work following the breach was excessive. It was there stated:

> "A singular feature is that the work progress payments appear to have greatly exceeded the value of the work, but this point is not strenuously argued, although it is mentioned in the surety's brief. In view of the derelictions referred to, however, the Court cannot find that the plaintiff should have been aware of the disparity between the value of the work done and the payments made, particularly, since the cost of remedying the defective workmanship was shown to be, as is usually the case, wholly disproportionate to the result. Such defects account, at least in part, for the unwillingness on the part of the builders to submit bids for completion of the job."

Appellants contend "simple calculations and common sense show that if appellant Soby had completed the Eielson painting contract, by doing the remaining 8% of the work based upon the agreed contract price, the cost to appellees would have been approximately $5,900.00." [11]

If the Eielson project could have been completed for the sum of $5,900.00, U. S. F. & G. made a serious error in not permitting Soby to continue under that particular subcontract. However, in contrast, U. S. F. & G., after examining the projects in December, 1953, established a reserve of $70,000.00 (Ex. J(a)).

[11] (App. Br. p. 29).

Harold Stenson, the general superintendent for appellees, testified that on December 19, 1953, the Eielson progress of Soby's subcontract was as follows: that building 5303 was about 35% completed; that building 5304 was around 25% completed; that building 5305 was around 20% completed (Tr. 1186).

An examination of the government inspectors' reports, which reports list the buildings and the work being performed therein, together with the number of men working in each trade, is informative and authentic on the extent of the work required to complete the unfinished painting subcontract as of December 19, 1953 (Ex. 36). These reports show 5536 hours of work performed by Larsen's employees subsequent to January 1, 1954, which hours are substantiated by the time cards and the payroll records (Exs. D, E).

When appellees knew Soby had consulted an attorney before Larsen commenced work (Ex. J(a)); when Soby's complaint was filed April 19, 1954, before the projects were concluded (Tr. 13); when two representatives of U.S.F. & G. not only inspected the projects prior to Soby's abandonment, but interviewed Larsen's superintendent and later, with full knowledge of the contract terms, expressly approved the hiring of Larsen (Exs. J, J(a)); when a professional engineer hired by Soby inspected the projects in February, 1954 (Tr. 1636); when none of the witnesses for appellants testified to the charge now made of "feather-bedding, padding and collusion"; when, in addition to the witnesses present at the trial who would have personal knowledge if there was any truth to such charges, no government

personnel or former employees of Soby (including his Eielson foreman) were called as witnesses; when both appellants received weekly statements showing all expenditures and costs, including interest charged, as the projects were being completed; and when no profit or markup for Kuney Johnson Company was charged, it is impossible to impute substance to the inferences now suggested by appellants.

2. Appellees' Reasonable Costs Expended in Completing the Unfinished Work Following Soby's Abandonment Were Not Only Liquidated but Ascertainable as Soon as Such Costs Were Incurred, and the District Court Did Not Err in Awarding Interest on Such Sums.

Appellants now erroneously assume that the costs of completing the unfinished work from and after December 19, 1953, were not liquidated and, therefore, no interest should be allowed appellees prior to the date of Judgment.[12]

Contrary to the contention made in appellants' brief,[13] appellees' cross-complaint was in no way prem-

[12] App. Br. p. 31. The Alaska Statute reads in part: "The rate of interest in The Territory of Alaska shall be six per centum per annum and no more on all moneys after the same become due. . . . " Sec. 25-1-1 Alaska Complied Laws Annotated (1949).

[13] Appellants cite no cases in support of the proposition: "While there are numerous cases involving building contracts, which have permitted interest to be allowed upon the award of damages for deviations or defective performance, it should be noted that all these cases involve claims based upon expressly stipulated contract prices, subject only to changes because of varying additions and deductions. In the present case, on the other hand, the claim upon which interest was allowed, arises out of an alleged breach of contract, whereby the claimant has mitigated his damages by permitting someone else to complete the work required by the contract and now seeks the contract price paid for such completion not as a liquidated claim based upon agreement

ised upon *quantum meruit* but was, in fact, a breach of contract action for Soby's failure to perform his subcontracts (Tr. 34).

In *United States v. United States Fidelity and Guaranty Company,* 236 U.S. 512, 59 L.ed. 696, 35 S.Ct. 298 (1915), a contractor had abandoned his contract with the government for construction of a public building for an entire price. The Supreme Court held that the government was entitled to its actual damages sustained through the contractor's default and in effect, abandonment of the contract. Interest was allowed from the date when, by the terms of the contract, the project should have been completely finished.

15 Am. Jur. Sec. 168, p. 584, "Damages," states:

> "Interest when allowed as damages runs from the date when the right to recover a sum certain is vested in the plaintiff. In actions for breach of contract, it ordinarily runs from the date of the breach or the time when payment was due under the contract."

See also *Puget Sound Pulp & Timber Co. v. O'Reilly,* 239 F.(2d) 607 (9th Cir., 1957).

The reason interest is not allowed on unliquidated damages is because the person liable does not know what sum he owes, and therefore, cannot be in default for not paying. 15 Am. Jur., Sec. 161, p. 580, "Damages."

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between the parties, but as his measure of damages." (App. Br. p. 30, 31).

If this were a correct statement of the law it would mean that after a breach of contract there would have to be "an agreement between the parties" before a claim could be liquidated. This has never been the law on interest as damages.

The record shows that both Soby and U.S.F. & G. received weekly statements from appellees setting forth the actual direct field costs, without overhead, profit or mark-up (Tr. 1504, 1505, Ex. F). Therefore, it is abundantly clear that appellees completion costs were at all times known to and ascertainable by both appellants. The interest due thereon was submitted to the appellants on invoices solely for that purpose under dates of April 30, 1954, and August 31, 1956 (Tr. 45, 46, Exs. F, I).

In *Miller v. Robertson,* 266 U.S. 243, 257, 258, 69 L.ed. 265, 275, 45 S.Ct. 73 (1924) the plaintiff was awarded damages for breach of contract, wherein defendant failed to continue performance and plaintiff was compelled to sell the subject matter of the contract at a reduced price. On the question of interest, the Supreme Court stated:

> "... One who fails to perform his contract is justly bound to make good all damages that accrue naturally from the breach; and the other party is entitled to be put in as good a position pecuniarily as he would have been by performance of the contract ... One who has had the use of money owing to another justly may be required to pay interest from the time the payment should have been made. Both in law and in equity, interest is allowed on money due ...
>
> "In this case at least (from) ... the date of demand, the seller was entitled to have from the buyers the difference between the sum which it would have received prior to that date, if the buyers had kept the contract, and the amount it received on resale ... All damages had accrued prior to the

> demand. There was nothing dependent on any future event. The elements necessary to a calculation of the amount the seller was entitled to have to make it whole . . . were known or ascertainable . . .".

In *Westland Construction Co. v. Chris Berg, Inc.*, 35 Wn.(2d) 824, 835, 215 P.(2d) 683, 690 (1950) a general contractor sued a plastering subcontractor for the increased cost of plastering when the subcontractor failed to perform, together with interest paid by the general contractor on money borrowed. The court allowed the damages and interest saying:

> "Where a contractor refuses to perform his contract, damages may be recovered for the difference between the contractor's bid and the actual cost to the owner of having the work performed by others . . . Likewise, interest on money borrowed by the owner to finance a construction project, accrued while the work is held up by a delay occasioned by the refusal of a contractor to perform, is a proper element of damage . . . ."

The record shows that appellees were paying interest at the rate of six per cent during the performance of the Ladd and Eielson projects (Tr. 1509).

Appellants cite two 1905 cases[14] but acknowledge that the present rule on awarding interest is that it may be allowed even on unliquidated claims if the amount due is capable of being ascertained by computation. However, the two cases cited on this point by appellants, while recognizing that interest can be allowed even on unliquidated claims when ascertainable, deal with

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[14] (App. Br. p. 31).

claims based solely upon *quantum meruit,* and the facts therein are not analogous to the instant case.

Appellants also cite *Columbia Lumber Co., v. Agostino,* 184 F.(2d) 731 (9th Cir. 1950), and apparently contend that since there was a set off allowed in the instant case, the appellees' damages are unliquidated. This decision involved an implied promise to pay a reasonable amount and is not in point. There was held to be no meeting of the minds on the contract price, and therefore, the case clearly was one of *quantum meruit.*

The fact that there is a set off will not defeat the right to interest based upon either a liquidated or ascertainable sum:

> "Where the amount of a claim under a contract is certain and liquidated or is ascertainable, but is reduced by reason of the existence of an unliquidated set off or counter claim thereto, interest is properly allowed upon the balance found to be due from the time it became due and was demanded or suit was commenced therefor . . ." 15 Am. Jur. Sec. 167, P. 584 "Damages."

The correctness of the above ruling is illustrated in *Mall Tool Co. v. Farwest Etc.,* 45 Wn.(2d) 158, 177, 273 P.(2d) 652, 663 (1954), where the court pointed out the inequity of denying interest when a counter claim or set off is alleged:

> "An unliquidated counter claim, even when established, does not affect the right to interest prior to judgment on the amount found to be due on a liquidated or determinable claim, since the debtor may not defeat the creditor's right to interest on such a claim by setting up an unliquidated claim as a set off . . . ."

U.S.F. & G's bond provides for indemnity against "direct or indirect damage that shall be suffered" (Ex. B). Appellees claim was liquidated and ascertainable and the Judgment for interest was the only decision possible under the law.

3. The $3,000.00 Inventory Credit Allowed by the District Court (Increasing the Credit Allowed Soby by Appellees from the Figure of $616.00) Was Well Within the Evidence.

Appellant Soby was unable to produce competent evidence of an inventory for his materials and supplies left on the projects, December 19th, 1953, when he abandoned his contracts (Tr. 499-505).

Because of the lack of evidence presented by Soby, on his case in chief, with respect to the value of the materials and inventory remaining when the contracts were abandoned, the District Court permitted Soby to use appellees' Exhibits S-(1) and S-(2) in estimating the value of the materials and Inventory as listed on these exhibits (Tr. 1694).

Exhibit S-(1) pertained to materials remaining at Ladd and Soby estimated the total value of the items shown on said Exhibit to be $4,829.50. On Exhibit S-(2) which pertained to Eielson, Soby estimated the materials and inventory to be valued at $2,603.25. Therefore, his estimate of the total value of materials, inventory and equipment remaining at both the Ladd and Eielson Projects was the sum of $7,432.75 (Tr. 1694-1695). The $1200.00 value of the pick-up truck listed on this exhibit must be deducted because Soby recovered it (Tr.

1696). In addition, the credit of $2,248.19, evidenced by Exhibit F must be deducted. [15]

When the value of the truck and the credit in Exhibit F is subtracted from Soby's total estimate of the value of items listed on Exhibit S-(1) and S-(2) there remains a total of $3,984.56.

Had the materials and inventory items left by Soby not been used in the completion of the work required, the damage claim of the appellees would have been increased because the identical items would have been needed and purchased by Larsen Brothers Painting Company. This fact was explained by Mr. Kuney (Tr. 1546).

Contrary to the contention made by the appellants that the $3,000.00 setoff is not supported by the evidence, the record shows that Tom Corbett, Larsen's superintendent, estimated the value of the materials left behind by Soby to be $2,391.00 (Tr. 1319). Mr. Kuney testified that it would take at least $3,000.00 worth of brushes, cloths, tools and ladders to properly

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[15] This credit in Exhibit F reads:

"4. Allowance for materials drawn from your job stock and used by us on other work not a part of your sub-contract.

Item	*Quantity*	*Amount*
Sandpaper	268 sheets	$ 32.16
Kitchen enamel	24 gallons	111.60
Joint cement (spackle)	1250 pounds	53.13
Flat wall paint	240 gallons	984.00
Primer-sealer	253 gallons	1,037.30
Joint tape (rolls of 500 feet)	10 rolls	30.00
Total		$2,248.19

"Note: Amounts credited under item 4 were established from the local market prices at Fairbanks, Alaska, at the time the materials were used."

perform the Ladd and Eielson painting subcontracts, but that upon the completion of such work these items would have a value not in excess of $1,200.00 to $1,500.00 to a going concern, and that the amount of $616.00 received by the sale appellees made was not an unreasonable figure under the circumstances (Tr. 1548).

Appellants concede the District Court is free to choose between conflicting evidence.[16] When the painting superintendent, Corbett, estimates the value of the items to be $2,291.00, (and Soby estimates the value to be $3,984.56), and the District Court arrives at the figure of $3,000.00 (the estimate of Mr. Kuney), it would appear the trier of fact was completely within his discretion in arriving at the ultimate figure, and such figure was more than fair to Soby.

Appellants' argument, which in its entirety appears on page 35 of their brief, contains no references to either the Transcript of Record or exhibits, and is merely the conclusion of the author of the brief. Appellants accuse the District Court of pulling "a figure out of a hat," but it would appear appellants are guilty of their own accusation.

CONCLUSION

Inasmuch as the appellants have conceded the weight to be accorded the District Court's Findings of Fact, any citation of authority in support thereof is deemed unnecessary. Neither do appellees deem it necessary to set forth authorities for the rule that the demeanor of

[16] (App. Br. p. 35).

the witnesses and their credibility is a matter for the trial court.

The judgment as to the cost to complete the Eielson sub-contract; the award of interest from September 1st, 1956, to date of judgment; and the inventory credit allowed Soby as a deduction from appellees' judgment on their first cross-complaint relating to the Ladd sub-contract, are supported in every particular by the testimony and exhibits now before this Court.

The judgment should be affirmed in its entirety.

Respectfully submitted,

PAUL R. CRESSMAN
RUMMENS, GRIFFIN, SHORT & CRESSMAN
LEE OLWELL
OLWELL & BOYLE
Attorneys for Appellees

PAUL F. ROBISON
Of Counsel for Appellees

APPENDIX A—EXHIBITS

Appellants have not complied with Paragraph 2 (f), Rule 18, rules of this court, as amended August 21, 1957. In lieu thereof and to assist the Court, appellees set forth a tabular index of those exhibits to which reference is made in appellants' opening brief and in appellees' brief. It will be noted that the record, as printed, does not indicate at what stage of the proceedings defendants' Exhibits I, S (1), and S (2) were admitted. It should be noted that the entire record was not printed and the three exhibits referred to each bear the stamp of the Clerk of the District Court, indicating that such exhibits were admitted in evidence.

Exhibit No.	*Identified*	*Offered*	*Received*
Pls' 1 (1)	Tr. 20	Tr. 20	Tr. 20
Pls' 2 (2)	Tr. 20	Tr. 20	Tr. 20
Pls' 13	Tr. 20	Tr. 20	Tr. 20
Pls' 36	Tr. 22	Tr. 22	Tr. 23
Pls' 46 (1)	Tr. 1197	Tr. 1197	Tr. 1197
Pls' 46 (2)	Tr. 1197	Tr. 1197	Tr. 1197
Defs' A	Tr. 22	Tr. 22	Tr. 22
Defs' B	Tr. 22	Tr. 22	Tr. 22
Defs' C	Tr. 22	Tr. 22	Tr. 22
Defs' D	Tr. 22	Tr. 22	Tr. 22
Defs' E	Tr. 22	Tr. 22	Tr. 22
Defs' F	Tr. 22	Tr. 22	Tr. 22
Defs' G	Tr. 22	Tr. 22	Tr. 22
Defs' H	Tr. 22	Tr. 22	Tr. 22
Defs' I	Tr. 22		
Defs' J	Tr. 22	Tr. 22	Tr. 22
Defs' J (a)	Tr. 22	Tr. 22	Tr. 22
Defs' S (1)			
Defs' S (2)			

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Pls' 13	Tr. 20	Tr. 20	Tr. 20
Pls' 36	Tr. 22	Tr. 22	Tr. 23
Pls' 46 (1)	Tr. 1197	Tr. 1197	Tr. 1197
Pls' 46 (2)	Tr. 1197	Tr. 1197	Tr. 1197
Defs' A	Tr. 22	Tr. 22	Tr. 22
Defs' B	Tr. 22	Tr. 22	Tr. 22
Defs' C	Tr. 22	Tr. 22	Tr. 22
Defs' D	Tr. 22	Tr. 22	Tr. 22
Defs' E	Tr. 22	Tr. 22	Tr. 22
Defs' F	Tr. 22	Tr. 22	Tr. 22
Defs' G	Tr. 22	Tr. 22	Tr. 22
Defs' H	Tr. 22	Tr. 22	Tr. 22
Defs' I	Tr. 22		
Defs' J	Tr. 22	Tr. 22	Tr. 22
Defs' J (a)	Tr. 22	Tr. 22	Tr. 22
Defs' S (1)			
Defs' S (2)			

Exhibit No.	*Identified*	*Offered*	*Received*
Defs' CC	Tr. 1404	Tr. 1404	Tr. 1404
Defs' DD	Tr. 1420	Tr. 1421	Tr. 1421
Defs' EE	Tr. 1423	Tr. 1424	Tr. 1425
Defs' II	Tr. 1505	Tr. 1505	Tr. 1505
Defs' JJ	Tr. 1505	Tr. 1511	Tr. 1511

APPENDIX B

MOTION FOR ATTORNEYS' FEES ON APPEAL

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ERIC SOBY, d/b/a Soby Painting Co., and UNITED STATES FIDELITY AND GUARANTY COMPANY, *Appellants,* vs. LLOYD W. JOHNSON and MAX J. KUNEY, d/b/a Kuney Johnson Company, *Appellees.*	No. 15823

TO THE HONORABLE, THE JUDGES OF SAID COURT:

COME NOW the appellees and respectfully move for an allowance for services rendered by their attorneys on this appeal.

This motion is based upon the records and files herein, together with the legal authority cited in appellees' brief and the affidavit of counsel hereunto attached.

WHEREFORE, appellees respectfully pray that this honorable court award them attorneys' fees on appeal herein.

Respectfully submitted,

LEE OLWELL
PAUL R. CRESSMAN
Attorneys for Appellees

STATE OF WASHINGTON }
} ss.
COUNTY OF KING }

PAUL R. CRESSMAN and LEE OLWELL, each being first duly sworn upon oath, depose and say:

That they are the attorneys for the appellees herein

and hereby make this affidavit in support of the Motion for Attorneys' Fees on Appeal above set forth.

The appeal in this case has been pending since May 2, 1957. Since that date and including the completion of appellees' brief herein, appellees' attorneys have expended the following hours during the years indicated below on matters directly connected with this appeal.

	1957	1958	1959	Total
Paul R. Cressman	16⅔	22½	147½	185½
Other Attorneys Associated with Rummens, Griffin, Short & Cressman	14	3⅚	17⅓	35⅙
Lee Olwell	10	24	97	131
	40⅔	50⅙	261⅚	352⅔

GRAND TOTAL OF HOURS 352⅔

Prior to the oral argument, appellees' attorneys will file a supplemental affidavit stating further the number of hours expended by them on this appeal subsequent to the filing of this brief.

That they have read the foregoing motion, know the contents thereof and hereby declare under the penalty of perjury that the matters and facts there set forth are true and correct to the best of their personal knowledge.

PAUL R. CRESSMAN

LEE OLWELL

Subscribed and sworn to before me this 2d day of July, 1959.

KENNETH P. SHORT

Notary Public in and for the State of Washington, residing at Seattle

APPENDIX C

AUTHORITIES IN SUPPORT OF MOTION FOR ATTORNEYS' FEES ON APPEAL

The Act of Congress, 31 Stat. 321, Ch. 786 (June 6, 1900) entitled "Act Making Further Provisions for a Civil Government for Alaska, and for other Purposes," Section 509 provides as follows:

"Measure and Mode of compensation of attorneys should be left to the agreement, express or implied, of the parties; but there may be allowed to the prevailing party in the judgment certain sums by way of indemnity for his attorneys fees in maintaining the action or defense thereto, which allowances are termed costs." This provision was codified by the Alaska Territorial Legislature, A.C.L.A. Sec. 55-11-51 (1949).

The rule is well established that when a state or territorial statute allows attorneys fees to be taxed as costs, Federal Courts sitting in that jurisdiction will abide thereby. *Phoenix Indemnity Company v. Anderson's Groves, Inc.,* 176 F.(2d) 246 (5th Cir. 1949); *Willard v. Serpell,* 62 Fed. 625 (1894).

Pursuant to the above law, the District Court in the instant case awarded appellees $10,000.00 for attorneys fees to the date of judgment (Tr. 95).

As was stated in *American Can Co. v. Ladoga Canning Co.,* 44 F.(2d) 763 (1903):

> "The District Court, however, could not and doubtless would not, take into consideration the uncertain factor of a possible appeal, nor the legal services which might be rendered in case an appeal was prosecuted. Since the judgment was entered in the District Court, defendant has taken this appeal, and plaintiff's attorneys have rendered additional necessary and substantial legal services. . . . "

> "The statute authorizing plaintiff's recovery of reasonable attorneys' fees directs their inclusion as a part of the costs. We find nothing in this statute which limits this allowancee to services rendered in the District Court. Its terms are broad enough to include plaintiff's reasonable attorney's fees necessarily incurred in any court wherein the cause was pending."

For cases wherein a Circuit Court of Appeals has awarded attorneys' fees on appeal in situations analagous to the instant case see:

Salmon Bay Sand & Gravel Co. v. Marshall, 93 F.(2d) 1 (9th Cir. 1937);

Radcliff Gravel Co. v. Henderson, 138 F.(2d) 549 (5th Cir. 1943);

Louisville & N. R. Co. v. Dickerson, 191 Fed. 705 (6th Cir. 1911).

No. 15,823

United States Court of Appeals

For the Ninth Circuit

ERIC SOBY, d/b/a Soby Painting Co., and UNITED STATES FIDELITY AND GUARANTY COMPANY,

Appellants,

vs.

LLOYD W. JOHNSON and MAX J. KUNEY, d/b/a Kuney-Johnson Company,

Appellees.

Appeal from the District Court for the Territory of Alaska, Third Division

REPLY BRIEF OF APPELLANTS

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No. 15,823

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REPLY BRIEF OF APPELLANTS

I. JURISDICTION

On May 15, 1959, appellants filed their opening brief herein, containing a Jurisdictional Statement which read in pertinent part as follows:

> "The District Court had jurisdiction of this case by virtue of the provisions of 40 U.S.C. 270 *et seq.* (49 Stat. 794), the so-called 'Miller Act'. * * * The Miller Act, * * *, covers subject matter directly within the cognizance and competence of a United States District Court (See: 28 U.S.C. 1331)."

Appellants' opening brief (O. Br.), at pp. 1-2.

Since then, on June 16, 1959, this Honorable Court decided the case of *Parker v. McCarrey,* No. 16,499, ... F.2d .....[1] Because of what was said there[2] it is now incumbent upon appellants to amend their previously submitted Jurisdictional Statement which was accepted by appellees.[3] The *Parker* decision, just quoted, relies for its holding upon an interpretation of the Alaska Statehood Enabling Act, Public Law 85-508, (72 Stat. 333, 48 U.S.C.A., 1958 Supp., pp. 4-13), and particularly Sections 12-18 thereof (see appendix to opinion in the *Parker* case, *supra*). Nothing in that Act contained has the effect of *changing* the character of the District Court for the Territory of Alaska, from which the present appeal is taken. On the contrary, Secs. 13 and 14 clearly show the intendment of the statute to be to continue that court in the same status and with the same powers and jurisdiction which it had prior to the Act, subject only to subsequent transfer proceedings as therein set forth.

It follows logically, that since the "territorial court" is not the "new United States District Court for the District of Alaska", *Parker v. McCarrey, (supra),* and since no United States District Court for the District of Alaska existed prior to the effec-

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[1]Not yet reported.

[2]"No one has suggested that the 'territorial court' which continues to act is the new United States District Court for the District of Alaska. And, such a suggestion could have no sensible basis."

[3]Appellees' brief, at p. 1; and see Transcript of Record, p. 36, for a statement of jurisdictional grounds relied on by defendants (appellees herein) for their "cross-complaint".

tive date (January 3, 1959) of the Act just referred to, no such court existed at the time the judgment here appealed from was entered and the court which entered it was the same "territorial court" referred to in the *Parker* decision and not a District Court of the United States for the District of Alaska.

It is undisputed[4] that both the original complaint filed below by plaintiff (appellant Soby herein) and the so-called cross-complaint filed below by defendants (appellees herein) were brought under the Federal statute popularly known as the Miller Act (40 U.S.C.A. 270(a)-271(d)).[5] The provisions of that Act which are here pertinent are contained in 40 U.S.C. 270(b) and read, in applicable part, as follows:

> "(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, *in the United States District Court* for any district in which the contract was to be performed and executed and not elsewhere, *irrespective of the amount in controversy* in such suit, * * *" (Emphasis supplied).

The language just quoted indicates plainly and without ambiguity that the forum designated by the Congress for suits brought under the statutory remedy created by the Miller Act is the United States District Court having appropriate venue, a court the jurisdiction of which is ordinarily circumscribed by limitations with respect to the amount in controversy.

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[4]Brief of Appellees, at p. 1 ("Jurisdiction").

[5]See footnote 3, *ante*.

Before the definitive pronouncement by this Court in *Parker v. McCarrey, supra,* quoted *ante* (footnote 2), the issue of whether the "District Court for the Territory of Alaska" is a United States District Court, was the subject of much controversy and seemingly conflicting decisions.

See, *e.g.,*

McAllister v. United States (1891), 141 U.S. 174, 11 S.Ct. 949, 35 L.ed. 693, affirming (1887), 22 Ct.Cl. 318;

United States v. Bell (1952), 14 Alaska 142, 108 F.Supp. 777;

But *cf.,*

International Longshoremen's & Warehousemen's Union v. Juneau Spruce Corporation (CA 9th, 1951), 13 Alaska 291, 189 F.2d 177, affirming (1949), 12 Alaska 260, 83 F.Supp. 224;

U.S. v. King (1954), 14 Alaska 500, 119 F. Supp. 398.

The decisions cited above, however, are not in irreconcilable conflict. Rather, they agree with, and to that extent anticipate, *Parker v. McCarrey (supra),* in holding that the District Court for the Territory of Alaska (the court below) is *not* a United States District Court. The *Juneau Spruce* case *(supra),* and the *King* case *(supra),* however, hold that notwithstanding this distinction, the territorial court is possessed of jurisdiction coextensive with that of United States district courts, under and with respect to certain specific statutes, namely, the Labor-Management

Relations Act, 1947, (29 U.S.C. 141 *et seq.*), and the so-called Tucker Act (28 U.S.C. 81 *et seq.),* by virtue of the legislative intent expressed in these statutes when read with the provisions of 48 U.S.C. 101, which established a territorial district court "with the jurisdiction of district courts of the United States and with general jurisdiction * * *". Appellants are not aware of any case binding upon this Court which has examined the jurisdiction of the territorial court under the Miller Act, with which the case at bar is concerned.

While *Parker v. McCarrey, (supra),* makes no reference to the *Juneau Spruce case, (supra),* nothing in the latter opinion that is necessary to the holding therein would appear to conflict with the later decision that the territorial court indeed is not and never was a district court of the United States. This Court in the *Juneau Spruce* case, *(supra),* however, points out that the Labor-Management Relations Act, 1947, *(supra),* uses the terms "United States District Court" and "courts of the United States" loosely and interchangeably; and therefore even though the territorial court is not a District Court of the United States, "it is unquestionably, and under any test, a 'court of the United States'." 13 Alaska 291, 307. Hence it was held that the language of this particular statute was such as to include "the district court for the territory of Alaska". *Loc. cit.,* at p. 310.

With respect to the Tucker Act, the court in the *King* case, *(supra),* appears to have based its main reliance upon the legislative history of the Judiciary

and Judicial Procedure Acts (Title 28 U.S.C.) and the Federal Tort Claims Act (60 Stat. 842, 61 Stat. 722)—which was merged with the Tucker Act for purposes of codification of procedures (see: 28 U.S.C.A. 1346)—as indicating an intent to include the district court for the territory of Alaska. See: 14 Alaska 500, 510-511.

Without weighing, at this time, the soundness of the last mentioned decision, which was not appealed to this Court, it seems sufficient to point out that none of the ambiguities or considerations of legislative history applicable to the Labor-Management Relations Act of 1947 or the Tucker Act, referred to *ante,* apply to the present issue of jurisdiction under the Miller Act. As has been shown above, the Miller Act employs clear and unambiguous language. Its jurisdictional scope is restricted to District Courts of the United States, having (initially) *limited* jurisdiction with respect to the amount in controversy, whereas the District Court for the Territory of Alaska was not and is not such a court and was not and is not subject to such specific jurisdictional limitations. Accordingly, under the Miller Act, there is no room for the interpretive niceties of the cases cited above, but as in the *McAllister* and *Bell* cases, *(supra),* the issue is clear cut: If the District Court for the Territory of Alaska is not a United States District Court, it has no jurisdiction. Since *Parker v. McCarrey, (supra),* this issue is no longer open. Nor is it necessary to indulge in the customary speculations regarding the conceivable economic and sociological conse-

quences of such an omission, since the Alaska Statehood Enabling Act, *(supra),* appears to have solved this technical problem by the creation of a true United States District Court for the District of Alaska.

Accordingly, the court below was without jurisdiction to entertain the litigation between the parties in this case. By virtue of the provisions of 28 U.S.C.A. 1291, 48 U.S.C.A. 1294 and of Sec. 14 of the Alaska Statehood Enabling Act, *(supra),* this Court had and continues to have appellate jurisdiction over proceedings and judgments in the territorial court. In the exercise of this appellate jurisdiction, this Court has the power and duty to dismiss the action below for lack of jurisdiction, even though the objection is made for the first time in the appellate court. This is true even where the question of jurisdiction was not raised in the Court of Appeals until argument upon rehearing (or as here, in appellants' reply brief), since the question of jurisdiction is always open and since, moreover, the appellate court could consider the question upon its own motion.

> *Black & Yates v. Mahogany Asso.,* (CCA 3rd, 1941), 129 F.2d 227, (on rehearing, 1942), 148 ALR 841, 853, cert. den. (1942), 317 U.S. 672, 63 S.Ct. 76, 87 L.ed. 539.

Accordingly, there is appended to this reply brief, and incorporated herein by reference, appellants' motion suggesting lack of jurisdiction on the part of the court below and requesting that the judgment entered be vacated and the actions set forth in the complaint and cross-complaint below be dismissed.

Based upon the foregoing, appellants hereby amend the Jurisdictional Statement contained in their opening brief (O.B., at p.1), to read as follows:

> *"Amended Jurisdictional Statement*
>
> Jurisdiction of the court below was invoked under the provisions of 40 U.S.C. 270(a) *et seq.* (49 Stat. 794), the so-called Miller Act. Appellants assert that the court below, being a 'territorial court' and not a District Court of the United States, lacked jurisdiction over the subject matter.
>
> On May 2, 1957, this Court acquired, and therefore now has, jurisdiction pursuant to 28 U.S.C. 1291, which then provided that the courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the District Court for the Territory of Alaska, etc., except where a direct review may be had to the Supreme Court; and 48 U.S.C. 1294 which designates this Court as the appropriate court for appeals from such judgments in the District Court for the District of Alaska. Public Law 85-508, approved July 7, 1958, effective upon admission of Alaska into the Union (January 3, 1959), eliminated the provisions which gave this Court jurisdiction of appeals from the District Court for the Territory of Alaska and established a United States District Court for the State of Alaska. However, Section 14 of that Act expressly continues the jurisdiction of this Court over all appeals taken from the District Court for the Territory of Alaska previous to the admission of Alaska as a state."

II. REPLY ARGUMENT ON THE MERITS

1. REPLY TO POINT (a) OF APPELLEES' FIRST ARGUMENT.

Appellees' brief requires some further comment, because, in some of its arguments, it proceeds to set up "straw-men", which are then painstakingly demolished. For instance, on page 8, appellees set up for argument a statement as follows: "Appellant's brief expressly concedes that Soby wilfully *(sic)* abandoned his subcontract without cause". Reference is then made to page 27 of appellants' brief.

An examination of that page of appellants' brief will show the concession of abandonment was made for the purpose of argument only. Appellant Soby's actual reason for stopping work on December 19, 1955, is set forth on pages 3 and 4 of appellants' brief, where it is stated that Soby was required to repaint some of the housing units under his contract as many as four times each, because the appellees used lumber and sheetrock containing excessive moisture which shrank under application of heat in the buildings, causing the painted surfaces to crack and joints to open. These defects, caused by appellees, forced appellant Soby to waste on re-do work moneys which he had planned to expend on performing his contract and thus, through the fault of appellees, Soby became insolvent and was forced, temporarily, to discontinue the progress of his work.

2. REPLY TO POINT (d) OF APPELLEES' FIRST ARGUMENT.

It was, of course, expected that the appellees would put forth in their brief the most advantageous (to them) version of their position with respect to appellants' charge that the costs claimed by appellees for completing the Eielson project were padded and thus unconscionable, but it was not anticipated that they would, with such brash contempt for the facts as well as the rules of arithmetic, manipulate figures to produce the manifestly absurd conclusion appearing in the middle paragraph of page 16.

In their attempt to re-analyze the clear and undisputed evidence contained in appellants' appendices 1 and 2 (Exhibits 46-1 and 46-2 below), which demonstrates that the claimed costs for Eielson were excessive, unsupportable and unconscionable, appellees have confused, to use a simile, apples with oranges.

Exhibit 46-2, the government payment estimate (appendix 2 to Appellants' brief) shows that the total sum of the Eielson contract at the prime contract level was $2,522,356.69. The exhibit also shows that the contract item of "interior finish" had a weight of 13.73% of the total contract or a dollar weight of $346,402.06. The exhibit further shows that the average percentage completion of the whole contract with respect to "interior finish" was 91.18%, leaving only 8.82% of "interior finish" to be performed to complete a full 100% of the project.

If "interior finish" had been painting—and painting *only*—then the appellees would have been in a position to claim from the United States the sum of

$346,402.46 for only one item of their contract, all of which they had subcontracted to appellant for $73,662.00. Now, it is quite obvious that appellees' item of "interior finish" included work other than painting.[6] It is equally obvious that when appellees take 8.82% of $346,402.46 and obtain the figure of $30,552.69 as the dollar value of the painting work remaining to be done at the time appellant Soby left the job, they are taking 8.82% of a figure which originally included many items other than painting. It is equally obvious why they have made this percentage application to the sum of $346,402.46 rather than the painting contract of $73,662.00. Appellees paid Larson, the painter hired to complete Soby's work, the sum of $33,251.06, which figure bears some resemblance to 8.82% of $346,402.46, *i.e.,* $30,552.69.

Appellant Soby's bid to Kuney-Johnson for performing the entire painting sub-contract at Eielson, was $73,622.00 (exclusive of extras). On December 31st, the date appellees filed their project progress estimate (Exhibit 46-2) with the United States, they claimed reimbursement from the United States for 91.18% for "interior finish" which item, together with other items of the contract completed, or nearly completed, made it possible for appellees to claim 97.41% of buildings complete and obtain payment from the United States for such percentage of completion. If, on this date, only 8.82% of "interior finish" remained to be completed and *that remainder was substantially all painting,* as claimed by appellants—*and*

[6] *cf.* Appellees' brief, pp. 13-14.

as expressly admitted by appellees (Appellees' brief, Note 9, page 16)—then this 8.82% factor must be applied to the *painting* item of $73,662.00 and not against all of the items under "interior finish" originally included in the aggregate sum of $346,402.46. Thus, 8.82% of $73,662.00 is $6,497.98, which is the true dollar value of the painting to be finished to make 100% completion possible.

This last figure corresponds closely with the testimony of appellants' accountant, Alford, who testified at the trial that on December 19th, the date appellant stopped work on Eielson, he had expended on that job $55,403.19 and could have fully completed his contract (performed all painting) for an additional expenditure of $4,541.00.[7] Considering that the average contractor in bidding a job includes, in addition to his actual estimated costs for labor and material, an additional 15% to cover overhead (compensation insurance, public liability, office expenses, etc.) and 10% more for profit, making a total of 25% over actual costs, it follows that $55,403.19 x 25% = $18,-415.50. Adding the normal overhead and profit to actual costs we arrive at a total figure of $73,818.69 or slightly in excess of the sum of appellant's contract (exclusive of extras). The actual sum necessary to *complete* "interior finish", assuming it was substantially all painting (as *admitted*), would then be based on the formula of 8.82% x $73,662.00 = $6,494.98, or a figure quite comparable to that given in the uncontroverted testimony of appellants' accountant that

[7]T.R. 1693.

Soby would have finished the job by expending $4,541.00 additional.[7a]

According to appellees' version, on the other hand, the "interior finish" portion of the Eielson job was 91.18% complete—or 8.82% incomplete, which corresponds to a dollar value in terms of the prime contract of $30,552.69, which appellees say was substantially all painting *(supra)*. This leads to the absurd result that the dollar value of the 8.82% unfinished painting work comes to 41.48% of Soby's price for doing *all* the taping, spackling and painting on the *entire* Eielson project. Yet appellees insist (on page 16 of their brief) that this is the correct yardstick to use in judging the reasonableness of the amount appellees paid Larson to finish Soby's work at Eielson!

In other words, appellees by the artful use of words and the juggling of unrelated figures have attempted to convey the impression to this Court that, according to the record, Soby left $30,552.69 worth of unfinished work at Eielson. It is, of course, true that when Larson finished the item designated "interior finish", the appellees, under the terms of the *prime* contract, were entitled to receive $30,552.59 from the United States, but this was based on appellees' gross contract price to the United States, which includes items other than painting, as well as the markup and profit over what appellees were obliged to pay their sub-contractors for the same work, which, of course, in the nature of such things, is considerably less than the prime contractor's price to the United States.

[7a]T.R. 1693.

The appellees claim that they paid Larson $33,251.-06 to finish Soby's incomplete work at Eielson. What was the estimated value of Soby's incomplete work? The undisputed figures show the incomplete portion to have been 8.82%. But 8.82% of what? Was it 8.82% of $346,402.46 as appelles would have the court believe, or 8.82% of Soby's contract price of $73,662.00? By appellees own admission, it cannot be the former because that would necessarily imply that at all times "interior finish" meant only painting. Yet appellees themselves emphasize that painting was only a fraction of the completed portion.[8]

Appellants submit, therefore, that when appellees, on page 16 of their brief take 8.82% of the prime contractor's "interior finish" figure of $346,402.46, of which only a part was painting, and then claim that the remaining work to be done—which *was* all painting—was of a dollar value of $30,552.69 (or 41.48% of appellant Soby's total contract for the *entire* job), they are once again resorting to the same kind of distortion that deceived the trial court and led it into error on the Eielson portion of the judgment.

III. STATEMENT IN OPPOSITION TO APPELLEES' MOTION FOR ATTORNEYS' FEES ON APPEAL

Appellees' motion for an allowance of additional attorneys' fees is ill-founded, due probably to out-of-state counsel's unfamiliarity with the local rule upon which they seek to rely.

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[8]Appellees' brief, at p. 13.

Appellees, on page 33 of their brief, correctly site Section 55-11-51, Alaska Compiled Laws Annotated, 1949, which codified the provisions of the Act of June 6, 1900, (31 Stat. 321, Ch. 786) with reference to the allowance of attorney's fees as part of costs, and which reads in pertinent part as follows:

> "* * * There may be allowed *to the prevailing party* in the judgment *certain sums* by way of indemnity for his attorney's fees in maintaining the action or defense thereto, which allowances are termed costs." (Emphasis supplied).

Appellees, however, do not appear to be aware of the standing rule of the District Court for the District of Alaska, which carries the statutory authorization into effect, and which reads in pertinent part as follows:

> "*Attorney's fees.* Allowance to prevailing party as costs: Unless the court, in its discretion, otherwise directs, the following schedule of attorney's fees will be adhered to in fixing such fees for the party recovering any money judgment therein, as part of the costs of the action allowed by law:* * *

		Non-Liens		
		Contested	Partly Contested	Non-Contested
First	$1,000	25%	20%	15%
Next	$1,000	15%	12.5%	10%
Next	$1,000	10%	9%	7.5%
Next	$2,000	5%	3%	1%
Next	$10,000	2%	2%	.5%
Next	$10,000	1%	1%	.5%
Next	$25,000	.5%	.5%	.25%

> * * * Should no recovery be had, attorney's fees for the prevailing party may be fixed by the court as a part of the costs of the action, in its discretion, in a reasonable amount. * * *"
>
> Amended Uniform Rules of the District Court for the District of Alaska, Rule 25 (a).

It is clear, therefore, that under the Alaska rule, attorney's fees may be allowed to the prevailing party, based upon a fixed percentage of the amount recovered, and without regard to man-hours, number of attorneys engaged in the handling of the case, or other criteria, which might ordinarily apply where there is no fixed standard and the fee is merely required to be "reasonable". Within the limitations of the discretion which may be exercised by the district court, the fee thus recoverable under the Alaska rule is very much like a contingent fee. Accordingly, the authorities relied on by appellees in support of their motion are simply not in point.

Their principal case, *American Can Co. v. Ladoga Canning Co.,* (CCA 7th, 1930), 44 F. 2d 763, for instance, arose under the terms of the provisions of Sections 2 and 4 of the Clayton Act (15 U. S. C. A. 13, 15) which reads, in pertinent part, as follows:

> "Any person who shall be injured in his business or property by reason of anything forbidden in the anti-trust laws may sue therefor in any district court of the United States * * * and shall recover three-fold the damages by him sustained, and the cost of the suit, including *a reasonable attorney's fee.*" (Emphasis supplied).

It has been held that the reasonable attorney's fees allowable under this Section to a successful plaintiff are *not* to be calculated on the basis of a contingent fee.

> *Twentieth Century-Fox Film Corp. v. Brookside Theatre Corp.,* (C. A. 8th, 1952), 194 F. 2d 846, 858, 859, cert. den. 343 U. S. 942, 72 S. Ct. 1035, 96 L. ed. 1348

Obviously, the amount of a "reasonable attorney's fee" cannot be finally determined until *all* of the attorney's work is done, including the prosecution or defense of an appeal. This is not true of the contingent or percentage arrangement, clearly contemplated by the Alaska rule and hence the case under the Clayton Act, relied on by appellees, is not apposite.

The same applies to the other cases cited by appellees in support of their motion, namely, *Salmon Bay Sand & Gravel Co. v. Marshall,* (CCA 9th, 1937), 93 F. 2d 1; *Radcliff Gravel Co. v. Henderson,* (CCA 5th, 1943), 138 F. 2d 549; and *Louisville & Nashville R. Co. v. Dickerson,* (CCA 6th, 1911), 191 F. 705. Both of the two gravel company cases first cited arose under the Longshoremen's and Harbor Workers' Compensation Act, as amended (33 U. S. C. A. 901 *et seq.*), which provides in pertinent part as follows:

> "No claim for legal services * * * rendered in respect of a claim or award for compensation * * * shall be valid unless approved by the deputy commissioner, or if proceedings for review of the order of the deputy commissioner in respect of such claim or award are had *before any court,* un-

> less approved by such court. Any claim so approved shall, in the manner and to the extent fixed by the deputy commissioner or such court, be a lien upon such compensation. * * *'' (Emphasis supplied).
>
> 33 U. S. C. A. 928 (a).

Hence the statute in question does not involve the allowance of attorney's fees as costs at all, but merely the approval of a lien against the ultimate money recovery by the claimant, out of which it must be paid. To the extent that this statute has any bearing by analogy, moreover, it is clearly distinguishable by use of its reference to the allowance of such fees upon review "in any court". Obviously, the language is broad enough to include appellate review in the United States Court of Appeals.

Finally, the *Dickerson* case, *(supra)*, cited by appellees, involved an action under the Interstate Commerce Act of February 4, 1887 (24 Stat. 384, 49 U. S. C. A. 1 *et seq.)*, as amended, and particularly Section 16 thereof, which provides in pertinent part as follows:

> "If a carrier does not comply with an order (of the commission) for the payment of money within the time limit in such order, the complainant, or any person for whose benefit such order was made, may file in the district court of the United States * * * a complaint setting forth briefly the causes for which he claims damages, and the order of the commission in the premises. * * * If the plaintiff shall *finally prevail* he shall be allowed a

reasonable attorney's fee, to be taxed and collected as part of the costs of the suit. * * *'' (Emphasis supplied).

49 U. S. C. A. 16 (2)

Here again, the statutory language used refers to a "reasonable" attorney's fee, which, by definition, must abide the final event of the litigation, to be then determined based upon the reasonable value of such services.[9] The use of the italicized word "finally" in the proviso quoted above, moreover, emphasizes this legislative intent.

As has been shown, the effect of the Alaska rule, as spelled out by the statute and court rule set forth above, is to the contrary. It is, of course, elementary, that in the absence of statute, in an action at law, attorney's fee are no part of the costs.

Maryland Casualty Co. v. United States, to Use of Hayward, (CCA 4th, 1940) 108 F. 2d 784, 786

Hence such a statute and the rules promulgated thereunder are in derogation of the common law and must be strictly construed. Even under a liberal construction however, the Alaska rule as stated above does not reasonably yield the result contended for by appellees. It does not seem necessary to belabor the point, moreover, that even if it did, they would first have to "prevail" in this Court before their claim could be consid-

[9]And compare the use of the words "certain sums" in the Alaska statute, (*supra*).

ered. Thus, to that extent, their motion, apart from being ill-conceived, is also premature.

Respectfully submitted,
EDGAR PAUL BOYKO,
HAROLD J. BUTCHER,
Attorneys for Appellants.

HARRY C. WILSON,
Of Counsel for Appellants.

(Appendix Follows.)

Appendix.

Appendix 3

No. 15,823

United States Court of Appeals
For the Ninth Circuit

ERIC SOBY, d/b/a Soby Painting Co., and UNITED STATES FIDELITY AND GUARANTY COMPANY,

Appellants,

vs.

LLOYD W. JOHNSON and MAX J. KUNEY, d/b/a Kuney Johnson Company,

Appellees.

APPELLANTS' SUGGESTION OF LACK OF JURISDICTION IN THE LOWER COURT AND MOTION FOR VACATION OF JUDGMENT AND DISMISSAL OF ACTIONS

To the Honorable, the Judges of Said Court:

Appellants herein respectfully suggest to this Honorable Court, that the court below, the District Court for the Territory of Alaska, lacked jurisdiction over the subject matter of this cause, to wit, causes of action arising under the so-called Miller Act, 40 U. S. C. 270(a) *et seq.*, (49 Stat. 794), because said court was not and is not a district court of the United States.

WHEREFORE, appellants respectfully represent that the judgment appealed from was and is null and

void and move this Honorable Court to vacate the said judgment and dismiss the causes of action set forth in the complaint and cross-complaint filed below in the above-entitled cause.

Dated, at Los Angeles, California, this 27th day of July 1959.

Respectfully submitted,
Edgar Paul Boyko,
Harold J. Butcher,
Attorneys for Appellants
By Edgar Paul Boyko

Harry C. Wilson,
Of Counsel for Appellants

POINTS AND AUTHORITIES
IN SUPPORT OF THE FOREGOING MOTION

This motion is based upon the record on appeal in this case, and the statutory and judicial authorities set forth commencing on page 1 of appellants' reply brief, *(supra),* which are prayed to be taken a part hereof, as if fully set forth herein.

Respectfully submitted,
Edgar Paul Boyko,
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See Vol. 30

No. 15,841

IN THE

United States Court of Appeals

For the Ninth Circuit

JOGINDAR SINGH CLAIR,
Appellant,

vs.

BRUCE G. BARBER, as District Director, Immigration and Naturalization Service, San Francisco District,
Appellee.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

JURISDICTIONAL STATEMENT.

This appeal is from a judgment (T. 27) of the United States District Court for the Northern District of California, Southern Division, in an action for judicial review of an order of deportation. The action was brought under Section 10 of the Administrative Procedure Act (5 U.S.C. 1009) and under the Declaratory Judgment Act (28 U.S.C. 2201), and jurisdiction of the Court below was predicated upon those sections and upon 8 U.S.C. 1329. Jurisdiction to review the judgment of the Court below is conferred upon this Court by 28 U.S.C. 1291.

STATEMENT OF THE CASE.

The facts are not in dispute. Appellant, a citizen of India, came to the United States as a seaman on August 27, 1940, aboard a vessel of British registry, and has remained continuously in the United States since that time. On February 1, 1955, he was served with a warrant of arrest in deportation proceedings (T. 9). Subsequently in those proceedings, he applied for suspension of deportation under 8 U.S.C. 1254(a)(1). His application for suspension of deportation was denied by the Special Inquiry Officer who ordered that appellant be deported if he failed to depart voluntarily from the United States (T. 9-14). On appeal, the Board of Immigration Appeals affirmed the denial of suspension of deportation for the stated reason that appellant "came into the United States on an allied merchant vessel during the war, left his ship and did not engage in seaman service during the remainder of hostilities" (T. 15).

STATUTORY PROVISIONS.

"(a) As hereinafter prescribed in this section, the Attorney General may, in his discretion, suspend deportation and adjust the status to that of an alien lawfully admitted for permanent residence, in the case of an alien who——

(1) applies to the Attorney General within five years after the effective date of this chapter for suspension of deportation; last entered the United States more than two years prior to June 27, 1952; is deportable under any law

of the United States and is not a member of a class of aliens whose deportation could not have been suspended by reason of section 19(d) of the Immigration Act of 1917, as amended; and has been physically present in the United States for a continuous period of not less than seven years immediately preceding the date of such application, and proves that during all of such period he was and is a person of good moral character; and is a person whose deportation would, in the opinion of the Attorney General, result in exceptional and extremely unusual hardship to the alien or to his spouse, parent or child, who is a citizen or an alien lawfully admitted for permanent residence; * * *"

(Section 244(a)(1) *Immigration and Nationality Act of 1952*—8 U.S.C. 1254(a)(1)).

SPECIFICATION OF ERRORS.

The errors relied upon by appellant are:

1. The District Court erred in holding that the administrative denial of appellant's application for suspension of deportation was a valid exercise of the discretion contained in section 244 of the Immigration and Nationality Act (8 U.S.C. 1254).

2. The District Court erred in holding that appellant was afforded due process and a fair hearing on his application for suspension of deportation.

3. The District Court erred in holding that appellee and the Board of Immigration Appeals lawfully

exercised their discretion in denying appellant's application for suspension of deportation on the sole ground that appellant came into the United States on an allied merchant vessel during the war, left his ship, and did not engage in seaman service during the remainder of hostilities.

4. The District Court erred in entering judgment that the complaint and action be dismissed.

THE QUESTION PRESENTED.

The issue on this appeal may be reduced to one question, as follows:

> Can the Board of Immigration Appeals properly deny an application for suspension of deportation on the sole ground that the applicant came into the United States in 1940 "on an allied merchant vessel" and "did not engage in seaman service during the remainder of hostilities?"

ARGUMENT.

THE ADMINISTRATIVE DENIAL OF THE APPLICATION FOR SUSPENSION OF DEPORTATION IS ARBITRARY AND CAPRICIOUS AND CONSTITUTES AN ABUSE OF DISCRETION.

The clear tenor of the decided cases is that, while suspension of deportation is a discretionary matter, denial of such an application is reviewable by the Courts for abuse of discretion.

We believe that the decision of the Court of Appeals for the Second Circuit in *Mastrapasqua v.*

Shaughnessy, 180 F. 2d 999, is directly in point. In that case, suspension of deportation had been denied for the stated reason that the seaman had arrived in the United States in March 1941 on an Italian ship which had been interned, the Board of Immigration Appeals having decided that discretionary relief from deportation should not be granted to aliens whose presence in the United States was due to the war. In that case, the Court said:

> "There seems to be no more rationality in this classification than there would be in arbitrarily refusing to consider discretionary relief for all left-handed men or for all those whose names begin with the first thirteen letters of the alphabet. Consequently, we conclude that the classification is capricious."

The Court thereupon ordered the relator released from custody unless within a reasonable time the immigration authorities exercised their discretion without regard to the aforesaid consideration.

Similarly, in the case of

> *U. S. ex rel. Partheniades v. Shaughnessy,* (D.C. N.Y.) 146 F.S. 772

the Court overturned an administrative decision denying suspension of deportation, pointing out that the discretionary power of the administrative authorities must not be exercised capriciously or arbitrarily, that it appeared that in denying the application the immigration authorities in that case had been "influenced by erroneous and extraneous facts" and that the denial of discretionary relief in that case had been based on "improper considerations".

In the recent case of *Application of Paktorovics* (D.C. N.Y.) 156 F.S. 813, 819, which involved the Attorney General's discretion to admit aliens into the United States under parole, the Court said:

> "Though the scope of judicial review of an act of discretion committed to the Attorney General is minimal, where the reasons provided are on their face capricious and arbitrary and do not involve considerations Congress intended to make relevant, the intervention of the courts is justified (citing cases)."

The Courts in other cases have frequently stated the rule to be that, although suspension of deportation is a matter of grace, denial of suspension of deportation is reviewable by the Courts where there has been abuse of discretion or arbitrary and capricious action.

U. S. ex rel. Matranga v. Mackey, 115 F.S. 45;

U. S. ex rel. Adel v. Shaughnessy, C.A. 2, 183 F. 2d 371, 372;

U. S. ex rel. Kaloudis v. Shaughnessy, C.A. 2, 180 F. 2d 489.

All these cases recognize that if an application for suspension of deportation has been denied on the basis of irrelevant reasons or arbitrary considerations, such action constitutes an abuse of discretion which is reviewable by the Courts. This is in accordance with the well-settled principle that arbitrary use of administrative authority is invalid *(U. S. ex rel. Knauff v. McGrath*, C.A. 2, 181 F. 2d 839).

> "Where the administrative authorities have applied against an individual or class a test not

based on any reasonable classification which would justify such discrimination, such action is arbitrary and capricious and must be set aside on judicial review."

Kraus v. Dulles, (C.A., D.C.) 235 F. 2d 840, 842.

To deny the privilege of suspension of deportation to aliens who happen to have arrived as seamen in 1940 on a so-called "allied" merchant vessel, while superficially possessing an appearance of reasonableness, is actually based on fanciful and irrelevant premises. There is no indication in the statute (8 U.S.C. 1254(a), supra) that it was contemplated that any distinction be made between aliens who arrived as seamen and aliens who arrived in any other manner, nor that any distinction be made between classes of seamen. The test is unreasonable since it would not bar a person who arrived as a stowaway, nor would it bar a seaman who came on a German ship or even on a vessel of a non-belligerant nation. Moreover, with regard to the asserted failure to perform service as a seaman during the remainder of hostilities, the record indicates that appellant registered under the Selective Service laws of the United States and thereby made himself available to perform whatever service the appropriate authorities might have demanded of him.

We submit, therefore, that upon analysis the proposition invoked by the Board of Immigration Appeals in denying discretionary relief involves a consideration wholly extraneous to the purpose of the suspen-

sion of deportation provision and wholly insupportable by any test of reasonableness. Where Congress has intended that aliens should be denied privileges under the Immigration and Nationality Act because of failure to perform military or other duties, it has specifically so privided in the statute (e.g. 8 U.S.C., Secs. 1101(a)(19), 1425, 1426, 1182(a)(22)). There is no indication in the statute that Congress contemplated that administrative officials should set up such an irrational distinction as to exclude from any of the discretionary benefits of the Act those who arrived on a merchant ship as crewmen if the ship flew the flag of a nation which later became an ally of the United States in World War II. By registering under Selective Service laws in the United States, appellant made himself available for any and all service which might be required of him by the competent authorities of the United States Government. For administrative authorities to speculate as to duties theretofore owed to a foreign country because of an individual's occupational status as a merchant seaman on a ship which flew the flag of that country would, in the words of the Court of Appeals for the Second Circuit in the *Mastrapasqua* case, supra, be no more rational than to deny relief to all left-handed men. As a matter of fact, there was probably more reason for an adverse decision in the *Mastrapasqua* case than in the case at bar, since *Mastrapasqua* was a merchant seaman of a country which shortly after his arrival became an enemy country. In any event, if the consideration invoked by the Board in the present case

be a valid basis for denying suspension of deportation, then the immigration authorities may devise almost any type of test, whether rationally relevant to the immigration function or not. The field for arbitrary classifications under any far-fetched theory or pseudo-principle—social, political or international—would be limitless. It is difficult to believe that in dealing with so grave a matter as deportation of an alien who has been in the United States for seventeen and one-half years, Congress intended to differentiate between otherwise equally deserving individuals on the basis of so tenuous, superficial, and far-fetched a consideration as has been applied in the case at bar.

As stated at the outset, it is undisputed that suspension of deportation is a discretionary matter, but administrative discretion may be reviewed for abuse, or where the denial is arbitrary or capricious. The situation involved in the case at bar and in the *Mastrapasqua* case, supra, is not distinctively different from cases in which the administrative decision has been set aside because the immigration authorities applied tests set forth in an inapplicable statute (Cf. *Barber v. Lal Singh*, (C.A. 9) 247 F. 2d 213). Here, as in the *Mastrapasqua* case, the immigration authorities seek to apply a test which has no rational relevance to the considerations prescribed by the applicable statute (8 U.S.C. 1254(a)(1). Their action is not sustainable on the theory that, by leaving his ship, appellant demonstrated a lack of sympathy for the cause of Britain which later became an ally of this country, for, as we have shown, appellant registered for service under the

Selective Service laws of this country and thereby placed himself in readiness to serve in accordance with any demand which this country might make upon him. The classification thus set up by the Board of Immigration Appeals is unreasonable, discriminatory, and unrealistic since it would not apply to non-seamen who may have come to this country during the period when their own country was engaged in World War II. In principle, the classification has no more rationality than that considered in the case of *Mastrapasqua v. Shaughnessy*, supra.

CONCLUSION.

The appellant has resided in the United States for seventeen and one-half years and is conceded to be a person of good moral character. In the determination of his application under the immigration statute for the privilege of suspension of deportation, we submit that he is entitled to have the application considered on its merits on considerations germane to the statutory purposes and that denial of his application for the reasons stated in the decision of the Board of Immigration Appeals constitutes unreasonable, arbitrary and capricious action and abuse of discretion. In accordance with the procedures followed in the case of *Mastrapasqua v. Shaughnessy*, supra, we submit that the immigration authorities should be required to exercise the statutory discretion to grant or deny suspension of deportation without regard to

the considerations upon which the Board of Immigration Appeals has heretofore rejected that application.

It is therefore submitted that the judgment of the Court below should be reversed.

Dated, San Francisco, California,
March 4, 1958.

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Attorneys for Appellant.

(Appendix Follows.)

Appendix.

Appendix

EXHIBIT INTRODUCED INTO EVIDENCE.

Transcript Pages 17-18—Case submitted by the District Court on the certified record of the administrative proceedings of the Immigration and Naturalization Service.

No. 15,841

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Appellant,

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BRUCE G. BARBER, as District Director, Immigration and Naturalization Service, San Francisco District,

Appellee.

On Appeal from the United States District Court for the Northern District of California.

BRIEF OF APPELLEE.

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On Appeal from the United States District Court for the Northern District of California.

BRIEF OF APPELLEE.

JURISDICTION.

Appellant by his complaint herein sought judicial review of the administrative disposition of his application for suspension of deportation. Traditionally, habeas corpus was the remedy whereby such relief was sought.

Jay v. Boyd, 351 U.S. 345;

Hintopoulos v. Shaughnessy, 353 U.S. 72.

The Supreme Court has approved the declaratory judgment action, 28 U.S.C. 2201, as proper to obtain

a judicial determination of eligibility for the exercise of the discretion.

McGrath v. Kristensen, 340 U.S. 162;
Ceballos v. Shaughnessy, 352 U.S. 599.

Ceballos is also authority for the proposition that the Attorney General is not an indispensable party, following *Shaughnessy v. Pedreiro,* 349 U.S. 48.

To the extent that the exercise of discretion may be reviewed, it would appear the same relief may be obtained by habeas corpus or by a complaint for review and declaratory relief.

Crain v. Boyd, 237 F. 2d 927;
Brownell v. Tom We Shung, 352 U.S. 180;
Leonard Cruz-Sanchez v. Robinson, 249 F. 2d 771;
Rystad v. Boyd, 246 F. 2d 246, cert. den. 1-7-58, 355 U.S. 912;
Wolf v. Boyd, 238 F. 2d 249, cert. den. 4-13-57, 353 U.S. 936.

STATEMENT OF THE CASE.

Appellant, a citizen of India, entered the United States on August 27, 1940, as a seaman on shore leave. He was then a member of the crew of a vessel of British registry. He failed to return to the vessel and has remained in the United States unlawfully since August 27, 1940. He has been found deportable on the ground that he was an immigrant without a visa at the time of his entry into the United States. His deportability on this ground is not challenged.

In the course of his hearing he made application for suspension of deportation under Section 244(a)(1) of the 1952 Immigration and Nationality Act (8 U.S.C. 1254(a)(1)). The special inquiry officer denied the application with the following statement:

> "It is to be noted that the respondent deserted an allied ship during a period when the United States was endeavoring to aid Great Britain during World War II and when every available seaman was sorely needed."

On appeal, the Board of Immigration Appeals restated the statement of the special inquiry officer as follows:

> "This relief was denied by the Special Inquiry Officer . . . because the respondent came into the United States on an allied merchant vessel during the war, left his ship and did not engage in seaman service during the remainder of hostilities."

STATUTES.

Section 244(a)(1) Immigration and Nationality Act of 1952. (8 U.S.C. 1254(a)(1)).

> "Sec. 244(a) As hereinafter prescribed in this section, the Attorney General may, in his discretion, suspend deportation and adjust the status to that of an alien lawfully admitted for permanent residence, in the case of an alien who—
>
> (1) Applies to the Attorney General within five years after the effective date of this chapter for suspension of deportation; last entered the United States more than two years prior to June

27, 1952; is deportable under any law of the United States and is not a member of a class of aliens whose deportation could not have been suspended by reason of section 19(d) of the Immigration Act of 1917, as amended; and has been physically present in the United States for a continuous period of not less than seven years immediately preceding the date of such application, and proves that during all of such period he was and is a person of good moral character; and is a person whose deportation would, in the opinion of the Attorney General, result in exceptional and extremely unusual hardship to the alien or to his spouse, parent or child, who is a citizen or an alien lawfully admitted for permanent residence; . . ."

* * *

Section 244(b), Immigration and Nationality Act of 1952. (8 U.S.C. 1254(b)).

"(b) Upon application by any alien who is found by the Attorney General to meet the requirements of paragraphs (1), (2), or (3) of subsection (a) of this section, the Attorney General may in his discretion suspend deportation of such alien. If the deportation of any alien is suspended under the provisions of this subsection, a complete and detailed statement of the facts and pertinent provisions of law in the case shall be reported to the Congress with the reasons for such suspension. Such reports shall be submitted on the first and fifteenth day of each calendar month in which Congress is in session. If during the session of the Congress at which a case is reported, or, prior to the close of the session of the Congress next following the session at which

a case is reported, either the Senate or the House of Representatives passes a resolution stating in substance that it does not favor the suspension of such deportation, the Attorney General shall thereupon deport such alien or authorize the alien's voluntary departure at his own expense under the order of deportation in the manner provided by law. If neither the Senate nor the House of Representatives shall, within the time above specified, pass such a resolution, the Attorney General shall cancel deportation proceedings. The provisions of this subsection relating to the granting of suspension of deportation shall not be applicable to any alien who is a native of any country contiguous to the United States or of any adjacent island, unless he establishes to the satisfaction of the Attorney General that he is ineligible to obtain a nonquota immigrant visa."

QUESTION.

Is the exercise of discretion by the Board of Immigration Appeals subject to judicial review?

ARGUMENT.

THE BOARD OF IMMIGRATION APPEALS HAS PROPERLY EXERCISED THE DISCRETION REQUIRED BY SECTION 244 (a)(1), AND ITS DECISION MAY NOT BE REVIEWED.

Appellee does not accept the proposition asserted by appellant as "the clear tenor of the decided cases".

The decided cases to which he refers include the following:

Kaloudis v. Shaughnessy (2 Cir.), 180 F. 2d 489;

Wolf v. Boyd (9 Cir.), 238 F. 2d 249, cert. den. 4-23-57, 353 U.S. 936;

Jay v. Boyd, 351 U.S. 345;

Hintopoulos v. Shaughnessy (2 Cir.), 233 F. 2d 705, affirmed 353 U.S. 72.

The opinion in the *Kaloudis* case was written by Chief Judge Learned Hand of the Second Circuit with the concurrence of Judges Swan and Chase. In *Wolf v. Boyd* of this Court, the opinion was written by Judge Barnes. Chief Judge Denman and Judge Bone joined without dissent.

The opinion in the *Wolf* case, pages 254-255, embraces a substantial portion of the opinion in the *Kaloudis* case by quotation. The following portions of the quotation are noted:

> "The interest which an alien has in continued residence in this country is protected only so far as Congress may choose to protect it; Congress may direct that all shall go back, or that some shall go back and some may stay; and it may distinguish between the two by such tests as it thinks appropriate. . . . and, if the relator has the privilege of inquiring into the grounds, he has been wronged, and the writ should have gone. An alien has no such privilege; unless the ground stated is on its face insufficient, he must accept the decision, for it was made in the 'exercise of discretion', which we have again and again declared that we will not review.

> . . . The power of the Attorney General to suspend deportation is a dispensing power, like a judge's power to suspend the execution of a sentence, or the President's to pardon a convict. It is a matter of grace, over which courts have no review, unless—as we are assuming—it affirmatively appears that the denial has been actuated by considerations that Congress could not have intended to make relevant. . . ."

In *Jay v. Boyd* (supra), the Supreme Court on page 354, footnote 16, quoted the following from Judge Hand's opinion in *Kaloudis:*

> "As stated by Judge Learned Hand, 'The power of the Attorney General to suspend the deportation is a dispensing power like a Judge's power to suspend the execution of a sentence, or the President's to pardon a convict.' "

From the same page (354) of the *Jay* case, the following was quoted in the opinion of the Court below (Tr. p. 21):

> "It (the statute) does not restrict the considerations which may be relied upon or the procedure by which the discretion should be exercised, although such aliens have been given a right to a discretionary determination on an application for suspension. Cf. *Accardi v. Shaughnessy,* 347 U.S. 260, a grant thereof is manifestly not a matter of right, under any circumstances, but rather is in all cases a matter of grace. Like probation or suspension of criminal sentence, it 'comes as an act of grace', *Escoe v. Zerbst,* 295 U.S. 490, 492, and 'cannot be demanded as a right', *Berman v. U. S.,* 302 U.S. 211, 213, and this unfettered discretion of the Attorney Gen-

> eral with respect to suspension of deportation is analogous to the Board of Parole's powers to release federal prisoners on parole."

Appellant here relies heavily upon the Second Circuit Court of Appeals' opinion in *Mastrapasqua v. Shaughnessy*, 180 F. 2d 999, decided about two weeks after *Kaloudis*. The panel of judges consisted of Augustus N. Hand, Chase and Frank. Judge Frank wrote the opinion of the Court. *Mastrapasqua's* application for suspension of deportation had been denied by the Board of Immigration Appeals in the following language:

> "The case is one squarely within the terms of the decision of the Attorney General in the *Lagamarsino* case and accordingly he cannot be granted the privilege of applying for suspension of deportation. The motion must therefore be denied." (p. 1001)

In the *Lagamarsino* case the Attorney General refused to legalize *Lagamarsino's* residence in that he was a seaman whose presence in the United States was the result of conditions arising out of World War II. Judge Frank (p. 1003) concluded:

> ". . . It seems clear that the Attorney General was acting in accordance with a 'policy' of refusing to consider whether or not to give discretionary relief of pre-examination to any persons coming within a fixed category, i.e.—those whose presence in the United States is due solely to war. It is also clear that the Board felt constrained by the *Lagamarsino* decision to apply the 'policy' based on this classification to *Mastrapasqua's* re-

quests for first pre-examination, and later suspension of deportation."

The case was remanded to the Immigration and Naturalization Service to exercise discretion.

Cf. *Accardi v. Shaughnessy,* 347 U.S. 260; *Shaughnessy v. Accardi,* 349 U.S. 280.

Appellant's position in reliance on *Mastrapasqua* is somewhat akin to Judge Frank's dissent in *Hintopoulos v. Shaughnessy,* 233 F. 2d 705, 709. The majority opinion written by Judge Hincks, concurred in by Judge Waterman, distinguished *Mastrapasqua* as a case in which the Board had failed or refused to exercise its discretion. In *Hintopoulos,* the Board had found him (Hintopoulos) eligible and "in the exercise of its discretion it denied the suspension applied for." (p. 708.) The Court then held that in its broad power in the formulation of its discretion the Board might properly take into account, among other factors, its concept of congressional policy as manifested in the 1952 Act. In so doing it relied on *Kaloudis v. Shaughnessy* (supra).

Judge Frank in his dissent pointed out that his "colleagues lean heavily on *United States ex rel Kaloudis v. Shaughnessy.*" His position was that *Hintopoulos* was like *Mastrapasqua.*

The Supreme Court affirmed the majority opinion in *United States ex rel. Hintopoulos v. Shaughnessy,* 353 U.S. 72. The Court said, page 77:

"The Board found that petitioners met these standards and were eligible for relief. But the

statute does not contemplate that all aliens who meet the minimum legal standard will be granted suspension. Suspension of deportation is a matter of discretion and of administrative grace, not mere eligibility. Discretion must be exercised even though statutory prerequisites have been met."

United States ex rel. Kaloudis v. Shaughnessy, 180 F. 2d 489;

United States ex rel. Adel v. Shaughnessy, 183 F. 2d 371;

Cf. *Jay v. Boyd,* 351 U.S. 345.

CONCLUSION.

It appears clearly in the case at bar that the appellee and the Board of Immigration Appeals have exercised the discretion vested in the Attorney General under Section 244 of the Immigration and Nationality Act of 1952 (8 U.S.C. 1254(a)(1)) and have denied to appellant the relief sought by his application for suspension.

The position of appellant, a seaman, who entered the United States on shore leave as a member of the crew of a British vessel in 1940, who thereupon deserted his ship and remained in the United States illegally, who thereafter "did not engage in seaman service during the remainder of hostilities" constitutes a sufficient reason on its face, in the exercise of the discretionary function, to deny the application.

It is respectfully submitted that in a valid exercise of the discretion contained in Section 244, the application of appellant was denied. The judgment of the District Court should be affirmed.

Dated, April 3, 1958.

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APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

Appellee contends that the discretion of the Board of Immigration Appeals to deny suspension of deportation is not reviewable. Appellant contends that it is reviewable if abuse of discretion or arbitrary action is involved.

Appellee relies principally upon the following decisions:

Kaloudis v. Shaughnessy, (C.A. 2) 180 F. 2d 489;

Wolf v. Boyd, (C.A. 9) 238 F. 2d 249 (cert. den. 353 U.S. 936);

Jay v. Boyd, 351 U.S. 345, 76 S.Ct. 919, 100 L. Ed. 1242;

Hintopoulos v. Shaughnessy, (C.A. 2) 233 F. 2d 705, affirmed 353 U.S. 72, 77 S.Ct. 618, 1 L.Ed 2d 652.

In those cases the Courts found that the administrative discretion had not been abused, that the administrative action had not been arbitrary or capricious and that it had not been actuated by irrelevant considerations. In each of those cases, the language of the opinion indicates that the result would have been otherwise if arbitrary action or abuse of discretion had been found. For example, in *Wolf v. Boyd,* supra, this Court said at page 254:

> "As Judge Frank of the Second Circuit in the Adel case said:
>
> 'The courts cannot review the exercise of such discretion, they can interfere *only when there has been a clear abuse of discretion or a clear failure to exercise discretion.' U.S. ex rel Adel v. Shaughnessy,* 1950, 183 F.2d 371, 372." (Italics added.)

This Court in the *Wolf* case, supra, also quoted the following from the opinion of Judge Hand in the *Kaloudis* case, supra:

> "We will assume *arguendo* that the contrary might appear; i.e., that the reason given might have been so clearly irrelevant that a court could say that the Attorney General had transgressed the statute,"

Both the *Wolf* case and the *Kaloudis* case involved membership in proscribed organizations. There is

nothing in either decision which would conflict with the principle laid down in the case of *Mastrapasqua v. Shaughnessy,* (C.A. 2) 180 F. 2d 999, wherein the Court of Appeals for the Second Circuit held that the Board abused its discretion in denying suspension of deportation on the sole ground that the alien's entry into the United States in 1940 had been due to wartime events, because the classification was arbitrary and unreasonable. Throughout the opinions in the *Wolf* case and the *Kaloudis* case, supra, are expressions recognizing that denial of discretionary relief on grounds which are arbitrary or capricious constitutes an abuse of discretion which is reviewable by the Courts. This is again clear from the following additional statement of this Court in the *Wolf* case, supra:

> "Further, the courts have no reviewing power under claim of due process of law *unless the denial of discretionary relief was arbitrary.*" (Italics added.)

In *Jay v. Boyd,* supra, (a case also involving membership in proscribed organizations), the Supreme Court construed the statute as permitting decisions based on matters outside the administrative record "at least when such action would be *reasonable.*" In that case, the Supreme Court found that the regulations permitting use of confidential information where disclosure would be prejudicial to the public interest, safety or welfare was "a *reasonable* class of cases in which to exercise that power." Thus again the Court applied the test of reasonableness of classification in determining the propriety of the administrative action.

Appellee also places strong reliance on the decision of the Court of Appeals in the case of *Hintopoulos v. Shaughnessy,* supra, but the decision of the Court of Appeals in that case contained the following language:

> "Only if the discretion is shown to have been formulated on arbitrary or illegal considerations, may the courts interfere" (p. 708).

The same exception was recognized in the decision of the Supreme Court in the *Hintopoulos* case, since in that case the Court specifically stated:

> "Nor can we say that it was abuse of discretion to withhold relief in this case. The reasons relied on by the hearing officer and the Board—namely, the fact that petitioners had established no roots or ties in this country—were *neither capricious nor arbitrary.*" (Italics added.)

Here again is recognition that where there is abuse of discretion or arbitrary and capricious action, the administrative decision may be subject to judicial review. Thus there is nothing in the *Hintopoulos* opinion inconsistent with the *Mastrapasqua* decision, supra.

In the case at bar, like the *Mastrapasqua* case, supra, the Board has endeavored to set up an arbitrary classification of persons to whom discretionary relief will not be granted. This classification is aimed solely at aliens who arrived as seamen; it is limited to those who at the time of arrival were employed on ships registered to some country which *later* became a cobelligerent of the United States in World War II; the classification does not include aliens who came as

stowaways, transits, visitors, or border jumpers, nor does it include seamen who arrived on neutral, German, or Italian ships. The failure to perform further sea service in World War II is made the basic consideration for denial of the discretionary relief, and no cognizance is taken of the fact that the appellant registered in the United States for Selective Service and was subject to such service, military or civilian, which the United States may have chosen to require of him. We submit that this classification is fully as arbitrary and capricious as was the classification involved in the *Mastrapasqua* case, supra. In the last-mentioned case, the Board said in effect "We will not grant him relief because he arrived on an Italian ship and did not depart because of war-time conditions;" in the case at bar, the Board in effect says "We will not grant him relief because he arrived on a British ship and did not continue to serve further as a seaman." In principle, the situations are the same. The consideration invoked by the Board in the one case is just as remote from the relevant factors pertaining to the relief of suspension of deportation as it is in the other. Unless it can be said that denial of suspension of deportation cannot be reviewed even if based upon an arbitrary classification, we submit that the case should be remanded to the immigration authorities for decision of the application upon its merits as this Court did in *Barber v. Lal Singh*, 247 F. 2d 213.

CONCLUSION.

We respectfully submit that to deny suspension of deportation on the sole basis that the person arrived as a seaman in 1940 and did not thereafter perform sea service constitutes abuse of discretion and arbitrary and capricious action, that by the imposition of an unreasonable classification appellant has been denied discretionary consideration on his application on its merits and that under the principles of the *Mastrapasqua* and *Lal Singh* decisions, supra, the matter should be remanded to the administrative authorities for consideration of the application for suspension of deportation without regard to the consideration upon which it has heretofore been rejected by the Board.

We respectfully submit that the decision of the Court below is erroneous and should be reversed.

Dated, San Francisco, California,
May 7, 1958.

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No. 15843

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER CHAUNT,

Appellant,

vs.

UNITED STATES OF AMERICA,

Respondent.

APPELLANT'S OPENING BRIEF.

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No. 15843

IN THE

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PETER CHAUNT,

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vs.

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APPELLANT'S OPENING BRIEF.

Jurisdictional Statement.

This is an appeal from a judgment of the United States District Court for the Southern District of California, Central Division, cancelling the certificate of citizenship of this appellant issued November 28, 1940. Jurisdiction is conferred upon this Court by 28 U. S. C. 1291.

Statement of the Case.

The action below was commenced by a complaint filed October 1, 1953 [T. 2].* After answer, and following denial of motions to dismiss [T. 59], an amended complaint and a second amended complaint were filed [T. 105, 180]. Trial was had upon the latter, on March 5, 6, 7, 8 and 12, 1957 [R. 1-550], without a jury.

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*References to the Clerk's Transcript are indicated by "T"; those to the Reporter's Transcript by "R."

Findings of fact and conclusions of law favorable to the Government were prepared and filed, together with the judgment [T. 561], and objections to them were overruled [T. 558]. Judgment was entered April 24, 1957.

The evidence at the trial consisted largely of testimony and documents offered by the plaintiff. Appellant testified only as an adverse party called by the Government [R. 532-538]. The evidence offered by him was in the form of documents [Deft. Exs. A to E, incl.].

The appeal is from the judgment as entered. By stipulation, approved by this Court, it was abated pending decision by the Supreme Court of the United States of the cases relied upon under Point I, below.

Statement of Points.

Appellant here asserts the following points:

1. That the evidence received at the trial was insufficient to support the findings of the trial court, and that the findings of the trial court are not supported by the evidence.

2. That the findings of the trial court are insufficient to support the judgment of cancellation and such judgment is not supported by the findings or the evidence.

3. That the judgment of naturalization was *res judicata* and conclusive of all matters covered by the complaint below.

4. That the statute under which the second amended complaint is drawn, Section 340 of the Immigration and Nationality Act of 1952 (8 U. S. C. A. 1451) on its face and in its application, is an *ex post facto* law and a bill of attainder violative of Article I, Section 9, of the Constitution.

5. That the statute on its face and as applied to the appellant deprives the appellant of due process of law in violation of the Fifth Amendment to the United States Constitution.

Questions Presented.

1. Whether the judgment, in so far as it is predicated upon findings of concealment and misrepresentation respecting Communist Party connection must not be reversed under the controlling authority of *Maisenberg v. United States,* 356 U. S. ....., 2 L. Ed. 2d 1056.

2. Whether concealment and misrepresentation respecting appellant's arrests support the judgment considering that (a) the trial court failed to find that any of the arrests were lawful and (b) that at least two of the three arrests relied upon appear, on the face of the record, to have been illegal because of conduct protected by, and under ordinances invalidated by, the First and Fourteenth Amendments.

3. Whether the decree granting appellant's petition for naturalization on November 28, 1940, was not *res judicata,* concluding finally all of the issues raised here in the complaint and the findings.

Summary of Argument.

The pleadings and findings in this case turn upon two clusters of facts, one relating to claimed concealment and misrepresentation by appellant of his status in the Communist Party and his basic political views; the other to fraudulent dissembling as to certain arrests.

The first of these branches of the case is disposed of by *Maisenberg v. United States,* 356 U. S. ....., 2 L. Ed. 2d 1056, read together with *Nowak v. United States,* 356 U. S. ....., 2 L. Ed. 2d 1048, decided after entry of the

judgment below. The other branch of the case gives way because two of the three arrests found to have been fraudulently concealed were illegal. This flaw undermines fatally the remaining support for the judgment.

Ultimately, principles of finality of decision disregarded by the trial court barred this action *ab initio,* and require that it now be dismissed; otherwise, serious questions of constitutionality must be confronted.

I.

In so Far as the Judgment Rests Upon Findings That Appellant Wilfully Concealed That He Was an Active and Leading Member of the Communist Party, and Fraudulently Misrepresented the Contrary, It Is Controlled by Maisenberg and Nowak, and Accordingly Must Be Reversed.

The complaint below (actually the second amended compaint), like that in *Maisenberg,* sought denaturalization of appellant upon both of the grounds prescribed in Section 340(a) of the Immigration and Naturalization Act of 1952.[1] Its allegations were found true by the trial court virtually *in haec verba.*[2] In respects identical to those which decided *Maisenberg,* the findings are without

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[1]66 Stat. 260, 8 U. S. C., Sec. 1451(a):

"It shall be the duty of the United States district attorneys for the respective districts, upon affidavit showing good cause therefor, to institute proceedings . . . for the purpose of revoking and setting aside the order admitting such person to citizenship and canceling the certificate of naturalization on the ground that such order and certificate of naturalization were procured by concealment of a material fact or by willful misrepresentation. . . ."

[2]The findings as to each cause of action are stated separately in the language of the second amended complaint, except for necessary formal adaptations. At some points the identity between the two causes incongruity; see, for example, Findings of Fact, First Cause of Action, par. VI, first line.

support in the evidence. It follows that the judgment, *pro tanto,* must be reversed.

(a) As were both *Nowak* and *Maisenberg,* appellant was naturalized under the Nationality Act of 1906 (34 Stat. 596). Like them he was asked the multiple question, No. 28 of the preliminary naturalization form [Govt. Ex. 2-A], which reads: "Are you a believer in anarchy? . . . Do you belong to or are you associated with any organization which teaches or advocates anarchy or the overthrow of existing government in this country? . . ." The holding of those cases, that the question "was too ambiguous to sustain" a finding of fraud predicated only on other findings of Communist Party membership governs this one.

(b) *Nowak* also held that the "fact that Nowak was an active member and functionary in the (Communist Party) does not of itself suffice to establish that Nowak knew of the Party's illegal advocacy." "Fragmentary episodes" involving "sporadic statements," all "equivocal," were insufficient to make up the deficiency.

The same "vital link in the Government's chain of proof" is missing in this case. To paraphrase a concluding sentence of the *Maisenberg* opinion, there is no evidence in the record that Chaunt himself ever advocated revolutionary action or that he was aware that the Party proposed to take such action.[3] (*Cf., Yates v. United States,* 354 U. S. 298, 319-322.) Here indeed there are no statements, equivocal or otherwise, nor any circum-

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[3]There is not even a finding to this effect with respect to the first cause of action, the concealment cause. The separate findings as to the second, misrepresentation, cause of action include recitals, lifted from the complaint, that appellant "well knew" the various dogmas attributed there to the Communist Party.

stances from which the inference of guilty knowledge might reasonably be drawn.[4]

Paraphrasing again, this time from *Nowak,* under the strict standard of proof by which this case must be judged the record shows at best from the Government's standpoint that Chaunt was an active member, leader and functionary of the Communist Party.[5] But this proof does not suffice to make out the Government's case, for Congress in the Immigration and Naturalization Act of 1952 has not made membership or holding office in the Communist Party a ground for loss of citizenship. The proof here falls far "short of the 'clear, unequivocal and convincing' evidence needed to support a decree of naturalization." (*Maisenberg, supra.*)

II.

Those Portions of the Judgment Which Rest Upon Findings of Fraudulent Concealment of Arrests Are Erroneous Because the Trial Court Failed to Find That Any of the Arrests Were Lawful, and at Least Two of the Three Arrests Found to Have Been Concealed Were Illegal.

This case would be disposed of by *Maisenberg* but for the fact that the judgment rests upon independent grounds not involved in that case. Here the complaint alleged and the district judge found that in his naturalization proceeding appellant denied ever having been arrested, when he had actually been apprehended and charged on three

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[4]The most pertinent quotation from appellant points the other way. Rushmore recalls Chaunt saying that the revolution would *not* be started by the Communist Party but by the workers at large [T. 244].

[5]In this discussion, as in the *Nowak* and *Maisenberg* opinions, it is assumed for convenience that the record adequately establishes in addition "illegal" advocacy by the Communist Party itself.

different occasions. The occasions and the charges, as set forth in identical language in each count of the complaint and the findings,[6] were:

> ". . . (2) that prior to said naturalization the defendant had been arrested and charged with violation of the city ordinances of the City of New Haven, Connecticut as follows: (a) On or about July 30, 1929, defendant was arrested on the charge that 'at said city and town of New Haven, Peter Chaunt, of the said city and town of New Haven, did then and there distribute in a public street, to wit: Ashmun Street, certain hand-bills against the peace of the State, of evil example, and contrary to the ordinance in such case made and provided. Ord. 729.' Disposition, 'Plea—not guilty—Discharged'; (b) On or about December 21, 1929, defendant was arrested on the charge that 'at said city and town of New Haven, Peter Chaunt, temporarily of said city and town, did make an oration, harangue, or other public demonstration in New Haven Green, outside of the churches. Pages 609 Charter and Ordinances.' Disposition, 'Demurrer filed 12-27-29. Demurrer overruled—Whitaker 12-27-28, plea—not guilty, Found J. S.'; (c) that on the 11th day of March, 1930, defendant was arrested and charged at said city and town of New Haven that he 'did commit, violate, Peter Chaunt, general breach of peace'; 'plea N. G., finding G, ordered to be imprisoned in New Haven County Jail and/or to pay fine of $25.00 to stand committed until judgment satisfied. Appealed.' "

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[6]An additional arrest was alleged in each cause of action of the complaint but does not appear in the findings.

Quite apart from their validity as a matter of law, to be discussed below, it may be noted that none of the arrests with which appellant is charged involves the slightest suggestion of moral taint. The fact that no evidence was offered—and hence, we must assume, that none could be found—of any other blemish on appellant's record at any time suggests that it must have been quite exemplary.

A. The Judgment Must Be Reversed Because There Is No Finding That Any of the Arrests Were Valid.

In a case whose authority and reasoning have withstood repeated distinction, the Third Circuit held that concealment of false arrests is not a basis for denaturalization on fraud grounds. (*United States v. Kessler* (C. A. 3), 213 F. 2d 53.) Such arrests are not a material fact which can throw any light on the character of the applicant; they are a nullity; and their concealment, as a matter of law, cannot be fraudulent. The reasoning and authority of this case are unanswerable in the analogous circumstances presented here.[7]

It is self-evident that to conceal or misrepresent a nullity is no concealment or misrepresentation, and therefore not a fraudulent concealment or misrepresentation. If I deny that I was ever convicted, when a judgment against me in a criminal case has been set aside and wiped out, I do not misrepresent. Yet the *fact* is I was once convicted. The contradiction is resolved by recognition that the only fact relevant to my qualifications for citizenship is whether I was ever *validly* convicted of any offense. My conviction upon an invalid charge can throw no light upon me, only upon those responsible for it.

The same is true of an arrest. While the bearing of even a valid arrest upon a man's character is at least questionable, the fact that he was once, twice or thrice arrested illegally contributes exactly nothing to his history. Whether the invalidity of the charge be factual (mistaken identity) or legal (non-existence of the offense charged), (*United States v. Kessler, supra*), a false arrest cannot

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[7]See Note, Developments in the Law—Immigration and Nationality, 66 Harvard Law Review, 643, 720 and n. 608.

in reason be a fact material to any issue in a naturalization proceeding.

Since this is a denaturalization case, the burden of proof "is substantially identical with that required in criminal cases" (*Klapprott v. United States,* 335 U. S. 601, 612), and every element of the charge must be established. Both "the facts and the law should be construed as far as is reasonably possible in favor of the citizen." (*Schneiderman v. United States,* 320 U. S. 118, 158.) An appellate court must make an "independent, close scrutiny" of the record (*United States v. Anastasio* (C. A. 3), 226 F. 2d 912, 919), in order to satisfy itself that the record leaves no "issue in doubt." (*Knauer v. United States,* 328 U. S. 654, 656.) Thus it was incumbent upon the Government here to prove that the arrests alleged to have been concealed by appellant were valid. But there is no evidence of this. It was not alleged in the complaint. It is not found by the trial judge either as to all or any of the arrests found to have been concealed.

B. At Least Two of the Three Arrests as a Matter of Law Were Invalid.

The record forecloses any implied finding or presumption of regularity to fill the gap. For at least two of the arrests were made under municipal ordinances which, on their face, collide with the First and Fourteenth Amendments. No presumption of constitutionality supports them. (*United States v. Carolene Products Co.,* 304 U. S. 144, 152-153, n. 4.) As examination will show, the charges drawn under these laws obviously were void.

The first arrest, on July 30, 1929, in New Haven, was under a complaint charging that Peter Chaunt "did then and there distribute in a public Street . . . certain handbills against the peace of the State, of evil example, and

contrary to the Ordinance in such case made and provided." [Govt. Ex. 1-A.] New Haven could not have required appellant to secure a permit to distribute decent handbills. (*Schneider v. State,* 308 U. S. 147; *Jamison v. Texas,* 318 U. S. 413.) The First and Fourteenth Amendments equally forbid his conviction for distributing them unless he were shown to have been disorderly or dangerously provocative. *Cantwell v. Connecticut,* 310 U. S. 296; *cf., Chaplinsky v. New Hampshire,* 315 U. S. 568.)

Government's Exhibit 1-B records the complaint against appellant on December 21, 1929, that he "did make an oration, harangue or other public demonstration in New Haven Green, outside of the churches." This is a charge purely of speech-making, without any attendant circumstances to warrant police interference with appellant's constitutionally-guaranteed right to talk. The cases just cited, and a hundred others before and since, declare that speech cannot be criminal except it incites action or plays up "fighting words." (See *Kovacs v. Cooper,* 336 U. S. 77.) The exceptions not being alleged, it must be assumed that they were not present.

Two of the three charges about which appellant is alleged to have deceived the government thus prove to be invalid as a matter of law. The arrests under them were therefore illegal and false. They were nullities. As such, the fact that they had occurred was not material to a consideration of appellant's application for citizenship, and was even beyond the examiner's proper power to inquire. (*United States v. Kessler, supra,* 213 F. 2d 53.)

The evidence as to the disposition of the criminal proceedings here casts further doubt upon the validity of the arrests and the findings of fraudulent concealment. In

the first case appellant was "Discharged" after a plea and finding of not guilty [Govt. Ex. 1-A]. Was the case thrown out because they had the wrong man? Or for want of evidence? Or, perhaps, because the magistrate recognized that the charge on the ordinance could not be squared with the First Amendment? On any of these hypotheses this arrest was false, not an arrest at all.

The record as to the disposition of the second charge is just as ambiguous. What happened in this case [Govt. Ex. 1-B] according to the findings was: "Disposition, 'Demurrer filed 12-27-29. Demurrer overruled—Whitaker 12-27-28, plea—not guilty, Found J. S.'" No translation or interpretation of the initials "J. S." appears. Standard lists of legal abbreviations do not include them. (1 C. J., Secs. 78-79.) There is nothing to support an inference that appellant's speech making passed the clear and present danger point any more than did that of Cantwell in a similar case from the same state. (*Cantwell v. Connecticut, supra,* 310 U. S. 296.)

The record on the arrest of March 11, 1930 [Govt. Exs. 1-D and 1-E] is equally unsatisfactory. While it indicates that appellant was later convicted on the general breach of peace charge brought that day, it ends with the entry "Appealed," without anything to show what became of the appeal. For all that appears, appellant's conviction may have been reversed on any of the multitude of grounds on which reversals customarily rest. Or it may have been based upon the breadth and vagueness of the statute (*Cantwell v. Connecticut, supra*), or perhaps its application to conduct protected by the First and Fourteenth Amendments to the Constitution.

Even assuming that the arrest of March 11, 1930, should be considered valid, in contrast to the first two

which on the face of the record must fall before the Constitution, the judgment still cannot stand. For there is no *finding* that any of the arrests were valid. No presumption avails to fill the gap. Moreover, the trial court's finding of fraud in the concealment and misrepresentation of the arrests is general and is made to rest equally upon all three. But at least two, as we have seen, were not arrests at all. They could not, as a matter of law, be fraudulently concealed. Two of the three legs upon which the finding rests thus collapse. The finding cannot stand on the one remaining for the finding itself becomes ambiguous. There is no way of telling whether the trial judge would have made it if there had been only the one valid arrest. This uncertainty is fatal to the finding. (*Stromberg v. California,* 283 U. S. 359, 367-368.) Without the finding, the judgment must fall.

III.

The Naturalization Decree Was Res Judicata and Conclusive of All Issues Covered by the Pleadings and Findings Below.

It is often assumed that the defense of *res judicata* is not available in denaturalization proceedings, and this plainly was the view of the trial court. This assumption rests upon imprecise reading of early decisions of the Supreme Court and has not been laid to rest by the conflicting views of the lower federal courts. (See *Developments in the Law—Immigration and Nationality,* 66 Harv. L. Rev. 643, 725, and cases there cited.) Examination of the decisions relied on and of the important language of Mr. Justice Douglas' opinion for the majority in *Knauer v. United States,* 328 U. S. 654, 670-674, quoted below, discloses that there is no case squarely holding that *issues actually litigated or subject to litigation* in the

naturalization proceeding may be re-opened by the Government later on in a proceeding to revoke the naturalization decree. And it seems significant that Congress, which must be presumed to have been aware of the state of the law on this question when it adopted the 1952 Act, said nothing expressive of an intention that *res judicata* should not apply in denaturalization cases—like this one—even where the Government relies only upon instrinsic fraud. While the elimination of the ground of illegal procurement does away with many situations where the defense was inapplicable because the record on its face showed the absence of an essential, "jurisdictional" qualification (for example, *United States v. Ness,* 245 U. S. 319), the language of Section 340 of the new statute is entirely open to the contention, which appellant makes here, that the naturalization decree is vulnerable to attack upon fraud grounds only for what has traditionally been known as extrinsic fraud, and not for any misstatement occurring in the proceeding itself.

It was in fact *United States v. Ness, supra,* which was thought to establish the proposition that *res judicata* is not defense to denaturalization. The opinion, however, as Professor Roche observes in his searching article, *Statutory Denaturalization: 1906-51,* 13 U. of Pitts. L. Rev. 276, 286, understood that there was no right of appeal by the Government from the decree of naturalization. Mr. Justice Brandeis wrote in *Ness* (245 U. S. at 326):

> "For Congress did not see fit to provide [in the 1906 Act] for a direct review by writ of error or appeal. But where fraud or illegality is charged, the Act affords, under Sec. 15, a remedy by an independent suit . . ."

Subsequently the Government's right of appeal in naturalization cases was confirmed. (*Tutun v. United States,* 270 U. S. 568.) But the Court did not again consider thoroughly the question of *res judicata.* To quote the Roche article:

> "Mr. Justice Holmes in the *Maney* case (Maney v. United States, 278 U. S. 17, 23) leaned heavily on the *Ness* case and dismissed the defense of res judicata in a sentence. The inadequacy of res judicata as a defense against denaturalization has since been assumed by the Court without argument or discussion."

In the *Maney* case the defendant contended that to refuse to recognize the defense of *res judicata* would be to give "special treatment" to naturalization decrees. The point is disposed of characteristically in the final sentence of Mr. Justice Holmes' opinion:

> "But it hardly can be called special treatment to say that a record that discloses on its face that the judgment transcends the power of the judge may be declared void in the interest of the sovereign who gave to the judge whatever power he had."

The weakness of the *Ness* and *Maney* cases, as well as of *Johannessen v. United States,* 225 U. S. 227, also commonly relied upon, as authority against the availability of *res judicata,* is placed beyond dispute when it is recognized that all of them involved decrees upon records which on their face exhibited the absence of an indispensable element. Thus in *Ness* there was an admitted failure by the applicant to accompany his petition for naturalization with the required certificate of arrival. In *Maney* the certificate of arrival was filed considerably after the petition. *Johannessen* was an *ex parte* judg-

ment to which the doctrine of *res judicata* was inapplicable. In two other often-cited cases similar defects of record were involved and, probably for that reason, the issue of *res judicata* was not even raised: *United States v. Ginsberg,* 243 U. S. 472, and *United States v. Thind,* 261 U. S. 204. All of these cases, therefore, involved decrees which were void for want of substantive jurisdiction.

But *res judicata* "is not applicable where the judgment in the original action is void," as for lack of jurisdiction, failure to give notice or hearing, or the incompetency of the tribunal. (*Restatement of Judgments,* Sec. 1, Comment c.) The principle of finality of judgments of course is operative only with respect to judgments which are claimed to be voidable for some cause such as fraud or mistake. Hence cases dealing with void naturalization decrees are not apt.

The latest extensive statement by the Supreme Court occurs in *Knauer v. United States, supra,* apart from a passing reference in *Schneiderman,* 320 U. S. 118, 124. The point upon which *Knauer* turned in the Court was the fraud found to have been committed by Knauer in taking the oath of allegiance after his admission to citizenship. In answer to the assertion that *res judicata* barred the revocation proceeding, the majority opinion by Mr. Justice Douglas begins by observing that where a decree is based upon what is later found to have been perjured testimony, the rule of *res judicata* under *United States v. Throckmorton,* 98 U. S. 61, 66, "goes no further than to say that the issue of fraud can become *res judicata* in the judgment sought to be set aside." The opinion then continues with language which clearly draws the line to which the Court has actually gone in foreclos-

ing this defense, and thus marks the degree to which the question is still open:

> *"We need not consider the extent to which a decree of naturalization may constitute a final determination of issues of fact, the establishment of which Congress has made conditions precedent to naturalization* [here quoting Sec. 4, subdiv. Fourth of the 1906 Act as amended]. *Those facts relate to the past—to behavior and conduct.* But the oath is in a different category. It relates to a state of mind and is a promise of future conduct . . . hence the issue of fraud *in the oath cannot become res judicata* in the decree sought to be set aside . . . [it] was not in issue in the proceedings and neither was adjudicated nor could have been adjudicated." (328 U. S. 654, 670-671.) (Emphasis supplied.)

The line could not have been defined more clearly.[8] Whether *res judicata* is a defense in a revocation suit based upon fraud consisting of perjured testimony in the naturalization is a question explicitly left open and undecided. No later statement by the Court, let alone any decision of this question, is reported. This evidently was recognized by this court in citing *Knauer* in its opinion in *Stacher v. United States,* 258 F. 2d 112, 120.

There is, then, no obstacle to the application of *res judicata* in the present case. Reasons of judicial policy and the public interest combine to support it. Denaturalization is a fraud action in which the universally-recognized ele-

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[8]It was stated differently but with equal force by the same member of the Court, concurring in *Schneiderman v. United States, supra,* at 161-162: "Fraud connotes perjury, concealment, falsification, misrepresentation or the like. But a certificate is illegally, as distinguished from fraudulently, procured when it is obtained without compliance with a condition precedent to the authority of the Court to grant a petition for naturalization."

ments of a cause of action for misrepresentation are indispensable. *Schneiderman v. United States,* 320 U. S. 118, 161-162; *United States v. Anastasio* (C. A. 3), 226 F. 2d 912.) The principle of finality of judgments, as understood today, declares that final judgments are voidable for fraud only if the fraud is of a sort to prevent knowledge of the claim or defense, or an opportunity to litigate it. (*Restatement of Judgments,* Sec. 121.) A judgment obtained merely by false or perjured testimony, or the production of false documents or even by conspiracy between the prevailing party and witnesses, is not open to later attack. (*Restatement of Judgments,* Sec. 126.) That is our case. The very complaint of the Government and the findings of the Court below alike declare that "in the proceedings which led to his naturalization" the appellant misrepresented and misled them as to his past behavior and conduct. (See *Knauer v. United States, supra.*) This is what once was called intrinsic fraud, what the *Restatement* (*supra*) calls securing a judgment by false or perjured evidence. Whichever formula is preferred the judgment, having determined issues litigable and actually litigated, is conclusive.

In an effort to escape this result the Government in its complaint and the trial judge in the findings declared that as a result of the concealment and misrepresentation by the appellant, the Government and the court were "foreclosed" from conducting the investigation which would have disclosed falsity. But this is mere conclusion. It is contrary to facts which the courts judicially know—the vast investigative resources of the federal government, the availability in newspaper files, court records, credit agencies and other sources of information about an applicant for citizenship in the areas where the petition discloses he has lived. It is simply not true to

say that the Government was "prevented" from conducting any investigation which its agents, in their discretion, might have deemed to be appropriate in the circumstances. All that can be said is that they chose to rely upon the information furnished by the applicant. If their reliance proved to be misplaced, as we must now assume under the findings, the issues nonetheless were raised by the inquiry in the naturalization proceeding and were finally determined there.

The "Preliminary Form for Petition for Naturalization" [Govt. Ex. 2-A], which contained the now famous Question 28 (Point I, *supra*) and the denial of arrests (Question 30) is dated November 8, 1939. The decree of citizenship was granted more than a year later, on November 28, 1940. Thus the Government had ample time (and, as the record shows, could have secured more) to verify all the information furnished by appellant if it chose to do so. There is no claim, proof or finding of diligence on the part of the Naturalization Service.

Since this is both a fraud and a denaturalization case, it was incumbent upon the plaintiff below to prove by the requisite margin (a) that it did not know about the arrests of appellant of which it now complains, (b) that it could not with the exercise of reasonable diligence have learned of them and (c) that it reasonably relied upon his statements. Relief from a judgment will always be denied where the aggrieved party failed to employ reasonable care to protect his own interests. (*Restatement of Judgments,* Sec. 129.)

In the circumstances presented here denial of the claim of *res judicata* would give rise immediately to difficult and basic constitutional questions. One is whether reopening of the judgment at the direction of the Congress

in the statute infringes the judicial power conferred in Article III. (See Rutledge, J., concurring in *Schneiderman, supra,* 320 U. S. at 165.) The other is the applicability of the *ex post facto* clause of Article I and of the due process clause. These questions need not be resolved if long-prevailing rules of finality of judgments are observed, as they plainly should be here.

Conclusion.

For all of the foregoing reasons the judgment of the District Court should be reversed with directions to dismiss the action.

Respectfully submitted,

JOHN W. PORTER,

Attorney for Appellant.

No. 15849

United States
Court of Appeals
for the Ninth Circuit

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Appellant,

vs.

LEONARD F. HARMAN and RUTH V. HARMAN

Appellees.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Central Division

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—3-28-58

No. 15849

United States
Court of Appeals
for the Ninth Circuit

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Appellant,

vs.

LEONARD F. HARMAN and RUTH V. HARMAN

Appellees.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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For Appellee:

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In the United States District Court for the Southern District of California, Central Division

No. 249-57 Y

LEONARD F. HARMAN and RUTH V. HARMAN,

Plaintiffs,

vs.

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Defendant.

FIRST AMENDED COMPLAINT DECLARATORY RELIEF ESTOPPEL INJUNCTION

Plaintiffs complaining of Defendant allege:

For a First Cause of Action

I.

American Casualty Company of Reading, Pennsylvania, is a capital stock insurance company duly licensed and qualified to write insurance in the State of California by the Insurance Commissioner of this State.

II.

Plaintiffs purchased a certain policy of insurance from Defendant, bearing designation No. HOB 16557, insuring Plaintiffs under various categories, in the face amount of $48,500.00, for the term com-

mencing May 5, 1955, and extending to May 5, 1958, on premises known as 666 Beachcomber Road, Portuguese Bend Club, [45*] Portuguese Bend, California. Endorsed on said policy was coverage against "'All Physical Loss' Building Endorsement" which, among other hazards, insured against and included the hazard of landslide.

III.

Plaintiffs purchased a certain policy of insurance from Defendant, bearing designation No. 04-500340, insuring Plaintiffs under various categories, in the face amount of $23,000.00, for the term commencing July 15, 1956, and extending to July 15, 1957, with an option in the insured to renew the policy annually for 4 successive years at a premium defined in the "Annual Renewal Plan Endorsement," covering premises known as 669 Seapoint Lane, Portuguese Bend Club, Portuguese Bend, California. Endorsed on said policy was coverage under dwelling buildings, "All Physical Loss" Form, which included the hazard of landslide.

IV.

Many other coverages were included in both of the aforesaid policies, including coverage against the hazard of fire.

V.

Neither party knew at the time of the writing of the aforesaid policies, of any unstable condition of the ground upon which the residences were built,

*Page numbering appearing at foot of page of original Certified Transcript of Record.

which constituted any special or extraordinary hazard.

VI.

In the month of October, 1956, certain evidences of landslide were noticeable on premises at 666 Beachcomber Road. Defendant was notified thereof and caused inspections to be made in October and December, 1956. The damage was part and parcel of a massive land movement several square miles in area, affecting the hillside, beach and the beach under the ocean in the vicinity of the Portuguese Bend Club. On January 21st a report in writing was made on damage from landslide on premises at 669 Seapoint [46] Lane. On January 22, 1957, a written memorandum of the landslide affecting 666 Beachcomber Road was made. No substantial repair work has been undertaken on either of the premises, because of the uncertainty as to the eventual extent of the damage and the proper steps to be taken.

VII.

The massive landslide referred to commenced in the Fall of 1956, and manifestations of it are occurring daily in the Portuguese Bend area, including the premises above referred to. Plaintiffs are informed and believe, and on such information and belief, allege that the movement will continue until the insured premises have become totally untenable. Each of the manifestations and evidences of the landslide is a part of the same casualty, event and hazard.

VIII.

Defendant knows that a destructive landslide has commenced; is still progressing, and will probably continue for a substantial period in the future.

IX.

Plaintiffs are informed and believe, and on such information and belief, allege that the landslide casualty will continue until the buildings on the aforesaid premises are destroyed and made uninhabitable and will be total losses.

X.

Under date of January 29, 1957, Defendant mailed notices of cancellation of the aforesaid policies to the Plaintiffs individually, that such cancellation becomes effective on February 4, 1957, at 12 o'clock noon.

XI.

On February 4, 1957, at eight thirty-five (8:35 a.m.) o'clock in the forenoon, the within suit was commenced by the filing of the Complaint with the Clerk of the Superior Court of [47] the State of California, in and for the County of Los Angeles, which is a court of competent jurisdiction; and that Summons of that court was thereupon issued on the said Complaint.

XII.

The cancellation notices aforesaid are an attempt to remove the coverage of insurance against landslide after the inception of the hazard and during

the continuity of a hazard insured against under the policy contracts.

XIII.

Plaintiffs are informed and believe, and on such information and belief, allege that insurance against all hazards included in the policies have now become unavailable under universal insurance underwriting practices. Plaintiffs have canvassed insurance officers and carriers extensively and have been unable to obtain insurance against fire or any other hazards. The aforesaid canvass was made specifically excluding landslide. Plaintiffs are informed and believe that if an insurer could be found to underwrite fire insurance on the said premises, that in the event of a loss by fire, the new insurance would be subject to proration to the insurance coverage afforded by the policies hereinabove referred to.

XIV.

Plaintiffs are informed and believe, and on such information and belief, allege that many insurance companies carrying comparable risks and coverage in the Portuguese Bend area are treating their insurance coverage as being a continued responsibility of the insurer.

XV.

The landslide is the proximate and efficient producing cause of the inability of Plaintiffs to obtain other insurance against casualties exclusive of landslide from other insurance carriers, and it is a loss or detriment resulting from the casualty [48] or event of the landslide.

XVI.

An actual controversy exists between Plaintiffs and Defendant relating to the legal rights and duties of the respective parties, in that Plaintiffs are interested under the insurance policies and contracts referred to herein, and Plaintiffs desire a declaration of their rights and duties with respect to Defendant and in, to, over and upon the said insurance policies and contracts, including a determination of the construction and validity of the said policies and contracts and the relevant provisions thereof.

XVII.

The controversy between the parties is as follows:

A.

(1) Plaintiffs claim that a total loss on premises has been constructively suffered during the term of the policy contracts; that the face amount of the insurance upon the buildings is now due and owing; and that the procedural steps and devices prescribed by the policies have been waived by the service of the said notices of cancellation.

(2) Defendant claims that the only loss payable under the policies and the continuing destructive forces herein alleged, is the damage resulting to the date of the proposed cancellation of the policies and that the Defendant will have no liability for damage from the landslide continuing past the stated date of cancellation.

B.

(1) Plaintiffs claim that the onset of the hazard of landslide is indivisibly related to other hazards insured against under the policies and that the Defendant's liability under the other hazards cannot be severed from its liability for all physical loss resulting during the progress of [49] the hazard or event of landslide.

(2) Defendant claims that the hazards insured against are severable from landslide and that if the Defendant has a continuing liability for landslide it can, in the interim, effectively cancel its liability for other hazards.

C.

(1) Defendant claims that it can cancel its insurance coverage after the start of a hazard insured against and before the hostile force or event has run its full course.

(2) Plaintiffs claim that after the known onset of the hostile force of landslide, the Defendant cannot stop its liability until the termination of the event.

D.

(1) Defendant claims that the contract provision for cancellation of the policies on five days' notice applies in any circumstances, regardless of the onset of a continuing casualty event.

(2) Plaintiffs claim that the status quo of the insurance coverage attaches and remains from the start of a casualty event insured against and con-

tinues until the destructive hostile force has ceased to act.

E.

(1) Defendant claims in the premises that it can cancel its liabilities, except as to landslide, on five days' notice.

(2) Plaintiffs claim that on the advent of, or there coming into being, or there becoming detectable a hostile or destructive force which is one of the hazards insured against; and the event being such as to render the Plaintiffs' property uninsurable against other hazards covered by the [50] policy contracts, the policies are not in any respect or part cancellable.

F.

(1) Plaintiffs claim that in the premises Defendant is estopped to claim a right to cancel the insurance coverages.

(2) Defendant claims that it, in accepting the proffered insurance risks; issuing its policy contract thereon; continuing for month after month its insurance coverage with earned premiums accruing thereon day by day during the period when the insurance risks were on a par with tens of thousands of comparable risks throughout the United States; its failure to inform Plaintiffs, during the time that they could easily have replaced the insurance coverages with policies of other underwriters, of Defendant's intent or disposition to afford less than the full protection that the Plaintiffs sought; and its attempted cancellation of its duly issued policies after

the Defendant underwriter learned of the operation of a hostile destructive force against the insured premises—does not create a situation estopping it from cancelling or claiming to cancel its policies.

G.

(1) Defendant claims it can cancel its policies under any circumstances on five days' notice.

(2) Plaintiffs claim that the right of an insurer, pursuant to statute and pursuant to insurance contracts issued and issuable only pursuant to statute, to cancel and terminate its insurance policies prior to the running of the full term of the contracts, is suspended when suit is [51] instituted and pending between the parties at the time the intended cancellation is to occur.

H.

(1) Defendant claims that its liabilites under the policies terminates upon the expiration dates of the policies.

(2) Plaintiffs claim that upon the stated termination dates of the respective policies, if the event of landslide be then continuing, the insurance coverage will remain in force and effect.

For a Second Cause of Action

XVIII.

Plaintiffs repeat and reallege Paragraphs I through XVII of their First Cause of Action with the same force and effect as if set forth herein at length.

XIX.

In the premises Defendant is estopped to assert cancellation of the policies, or any right to cancel the policies.

For a Third Cause of Action

XX.

Plaintiffs repeat and reallege Paragraphs I through XVII and Paragraph XIX with the same force and effect as if set forth herein at length.

XXI.

Plaintiffs have great property values at stake herein; are confronted with the making of vital decisions relative to preservation, transfer and salvage of their property; in the premises will be confronted with substantial questions of obtaining credit or of marshalling funds for to implement decisions as aforesaid.

XXII.

In the premises Defendant should be permanently enjoined from claiming cancellation of the policies by the notices described [52] in Paragraph X of this pleading, and from ever asserting cancellation thereby; should be enjoined from serving any other notice or notices of cancellation, from claiming cancellation of the policies or either of them or any parts of them, and from attempting in any manner to do or accomplish such things until the first of the following shall occur: (1) Defendant shall have performed everything necessary and proper for it to do

under the policy contracts, as witnessed (a) by the written statement of Plaintiffs, or (b) by further order of the court; (2) the landslide shall have stabilized and the Defendant shall have made payment for all damage occurring under the policies for losses under any of the risks insured against, as witnessed (a) by the written statement of the Plaintiffs, or (b) by finding and further order of the court.

Wherefore, Plaintiffs pray that this court declare its judgment:

1. That Plaintiffs recover $58,000.00 for damages to buildings, contents and additional living expense occasioned thereby.

2. That the said insurance policies are in full force and effect as to all hazards, from the inception of the landslide until the cessation of the hostile destructive forces.

3. That Defendant is estopped to question the validity of the said insurance policies, and the protection of the Plaintiffs thereunder; and to assert or claim any cancellation or termination thereof whatsoever.

4. That Defendant be enjoined from certain acts, pursuant to the prayer of Paragraph XXII.

5. That Plaintiffs recover their costs of suit.

6. That Plaintiffs have further and different relief as it may appear just and equitable to [53] the court.

Dated: March 4, 1957.

/s/ LYMAN A. GARBER,
Attorney for Plaintiffs.

Duly verified.

Affidavit of service by mail attached.

[Endorsed]: Filed March 6, 1957. [54]

[Title of District Court and Cause.]

ANSWER TO FIRST AMENDED COMPLAINT

Comes now the defendant for answer to plaintiffs' complaint, alleges:

I.

As to the allegations of paragraph VII, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averment that the movement will continue until the insured premises have become totally untenable.

II.

As to the allegations of paragraph VIII, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averment that the landslide will probably continue for a substantial period in the future.

III.

As to the allegations of paragraph IX, this defendant is without knowledge or information suffi-

cient to form a belief as to [107] truth of the averments of said paragraph.

IV.

As to the allegations of paragraph XI, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averments pertaining to the date and time of filing the alleged complaint.

V.

As to the allegations of paragraph XII, this defendant denies each and every allegation, thing and matter contained in said paragraph, except that this defendant admits that said cancellation notices were duly given pursuant to the terms of the alleged policies and were legally effective pursuant thereto.

VI.

As to allegations of paragraph XIII, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averments of said paragraph.

VII.

As to allegations of paragraph XIV, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averments of said paragraph.

VIII.

As to allegations of paragraph XV, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averments of said paragraph.

IX.

As to the allegations of paragraphs XVI and XVII, this defendant denies that there exists between the plaintiffs and defendant any legal controversy in that and by reason of the fact that the policies pleaded in the plaintiffs' complaint were duly, effectually and legally cancelled as of February 4, 1957. [108]

Further Pleading and for Answer to Plaintiffs' Second Cause of Action, This Defendant Alleges:

I.

As to the allegations of paragraph XVIII, whereby and wherein paragraphs I through XVII of plaintiffs' first cause of action is incorporated, the defendant refers to its answers to said paragraphs and by this reference incorporates said answers as though fully set forth herein.

II.

As to the allegations of paragraph XIX, this defendant denies each and every allegation, thing and matter contained in said paragraph.

Further Pleading and for Answer to Plaintiffs' Third Cause of Action, This Defendant Alleges:

I.

As to the allegations of paragraph XX, whereby and wherein paragraphs I through XVII of plaintiffs' first cause of action is incorporated, the de-

fendant refers to its answers to said paragraphs and by this reference incorporates said answers as though fully set forth herein.

II.

As to the allegations of paragraph XXI, this defendant is without knowledge or information sufficient to form a belief as to the truth of the averments of said paragraph.

III.

As to the allegations of paragraph XXII, this defendant denies each and every allegation, thing and matter contained in said paragraph.

Further Pleading for Defense to Plaintiffs' Complaint and Each of the Causes of Action Therein, This Defendant Alleges:

I.

That each of the policies pleaded in the plaintiffs' complaint [109] were written pursuant to and incorporated the terms and conditions of the California Statutory Fire Insurance Policy.

II.

That the said policies provided in part as follows:

"Cancellation of policy. This policy shall be canceled at any time at the request of the insured, in which case this company shall, upon demand and surrender of this policy, refund the excess of paid premium above the customary short rates for the

expired time. This policy may be canceled at any time by this company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered), will be refunded on demand."

III.

That the defendant duly gave notice pursuant to the aforesaid terms and conditions of the pleaded policies and that cancellation of said policies thereby became effective February 4, 1957, at 12:00 o'clock noon.

Wherefore this defendant prays judgment that:

(1) It be decreed that the policies pleaded in the plaintiffs' complaint were duly cancelled February 4, 1957;

(2) The plaintiffs take nothing by their complaint;

(3) The defendant have and recover its costs and disbursements herein; [110]

(4) For such other relief as is just in the premises.

BOLTON AND GROFF,

By /s/ GENE E. GROFF,
Attorneys for Defendant.

[Endorsed]: Filed April 19, 1957. [111]

[Title of District Court and Cause.]

STIPULATION BY PLAINTIFFS RE ISSUES FOR TRIAL

Stipulation by Plaintiffs Relative to Trial of the Within Causes of Action on or About June 11, 1957.

This Stipulation is predicated on the following facts:

(1) At the time of filing the Complaint herein Plaintiffs had:

(a) No knowledge of the date upon which trial of these causes of action would be had; nor

(b) Knowledge of how great the damage to the premises would be at the time of trial, which damage, quite conceivably could then have been total;

(2) Damage has been great to the property insured;

(3) Damage to the premises is not total at this time;

(4) The landslide is still continuing and it is impractical to determine the extent, nature, or cost of the engineering work and building which need to be done, or even to ascertain whether or not it is practical to effect repair of the premises; and [114]

(5) It is a matter of vital importance to Plaintiffs to obtain a binding declaration of the Court as to whether or not the purported cancellation of the said insurance policies is effective or is a nullity.

In the Premises Plaintiffs Stipulate for the Purposes of Trial on or about June 11, 1957:

Plaintiffs are making no claim that at this time a total loss on the premises has been suffered; and are not seeking at this time any monetary adjudication of the amount of the damages suffered by Plaintiffs on the insured properties. This stipulation is not a waiver of any damages suffered by Plaintiffs before or after the date of Trial, and Plaintiffs expressly reserve the right at any proper future time and at any proper forum, including this Court and this cause of action, to claim and prove any and all damages suffered by them on the insured properties.

Dated June 10, 1957.

/s/ LYMAN A. GARBER,
Attorney for Plaintiffs.

Receipt of copy acknowledged.

[Endorsed]: Filed June 11, 1957. [115]

[Title of District Court and Cause.]

STIPULATION TO VACATE SUBMISSION FOR OFFER OF PROOF

ORDER

It is hereby stipulated by the attorneys for the respective parties that the following order may be made, if it please the Court:

Order

I.

It is hereby ordered that the Order of Submission of the within causes of action, which was made June 11, 1957, after trial, be and hereby is vacated;

II.

It is hereby ordered that the causes will be reopened for further trial;

III.

It is hereby ordered that it be deemed that plaintiff makes the following offer of proof after objection was sustained [122] at the trial to the following question:

(Reporter's Transcript of Proceedings page 19, lines 14 to 17:)

By Mr. Garber: "Col. Harman, have you made any attempt to obtain fire insurance on your property from other insurance carriers?"

The offer of proof is as follows:

By Mr. Garber: "May it please the Court, the plaintiffs make the following offer of proof in support of the allegation of paragraphs XIII and XV of their First Amended Complaint.

"That if permitted to do so, Plaintiff Leonard F. Harman would testify that before February 4, 1957, and before the filing of the within cause of action, he went to the nearby city of San Pedro, California; that on one of the main business streets

of that city he went into an office which was clearly marked as the office of a local agent for the writing of insurance; that he stated to a person in charge that he wished to purchase fire insurance upon two houses that he owned; that he was informed by said person that they would not write fire insurance upon properties in the landslide area at Portuguese Bend; that he then went to another office on one of the main business streets of the city clearly marked as the office of a local agent in the insurance business; that he stated that he wished to buy fire insurance on the houses [123] referred to herein; that the person in charge there said that he could not write policies on houses located in the landslide area at Portuguese Bend; that he asked such person if insurance could not be obtained from Lloyds of London and was told by such person that fire insurance could not be available upon the said houses through Lloyds of London."

IV.

It is hereby ordered that it be deemed that defendant objects to the adducing of evidence pursuant to the foregoing offer of proof.

V.

It is hereby ordered that it be deemed that the Court rejects said offer of proof and sustains the objection thereto.

VI.

It is hereby ordered that causes now stand resubmitted on the record as augmented by the

aforesaid and that the parties have until July 19, 1957, to file simultaneous briefs.

Dated: August 9, 1957.

/s/ BEN HARRISON,
Judge United States District Court.

It is stipulated that the above Order may be made.

/s/ LYMAN A. GARBER,
Attorney for Plaintiffs.

BOLTON & GROFF,

By /s/ JAMES E. GROFF,
Attorneys for Defendant.

[Endorsed]: Filed August 9, 1957. [124]

[Title of District Court and Cause.]

OPINION

Harrison, Judge.

In this diversity action for declaratory relief, the plaintiffs seek to forestall a cancellation of two insurance policies covering two family structures located at 666 Beachcombers Road and 669 Sea Point Lane, located in the area known as Portuguese Bend Club, Portuguese Bend, California. This area is southerly of Los Angeles and westerly of the City of San Pedro.

The defendant issued fire insurance policies on the above-mentioned structures and included in said policies a provision insuring, among other risks, said premises against "All Physical Loss."

Both policies were in effect during the fall of 1956, when a massive and continuing land movement commenced in the Portuguese Bend area, affecting a large number of properties, including the two aforementioned. Damage was first noted by the insured in October, 1956. The company inspected the properties in November and December of 1956, and again in January, 1957. Damage was substantial and continuous. By January 26, 1957, the damages were estimated by the company at over $4,500 to 666 Beachcombers Road, and about $2000.00 on Sea Point Lane. On January 20, 1957, with full knowledge of the existing land movement, the company issued notices of cancellation of both policies, effective January 4, 1957, attempting to comply with Sections 650 and 2071 of the Insurance Code of California. (West's Annotated Calif. Codes.)

However, said notices of cancellation would not terminate liability where a continuing loss had already commenced, until the loss by damage had been complete or the cause of the loss had ceased. 29 Am. Jur. 261; 32 Corpus Juris 1246 (see cases cited thereunder); Globe & Rutgers Fire Insurance Company v. David Moffat Co., 154 Fed. 13. Nor would the expiration of the policy affect the liability of the defendant [130] where the damages continue incessantly. Pruitt v. Hardware Dealers Mutual

Fire Ins. Co., 112 F. 2d 140. Nor would an event which would ordinarily terminate the policy abrogate the coverage after the loss insured against commences. Davis v. Conn. Fire Ins. Co., 158 Cal. 766; see also 1 L.R.A. (N.S.) 364-9.

In Home Insurance Co. v. Heck, 65 Ill. 111, 116 (1872), the Supreme Court of Illinois held:

> "[I]f there was an impending fire from a quarter different from the one which first caused apprehension, the insurer would have no right to cancel the policy. It would be an act done in the face of a threatened and approaching danger, and which the insurers were not competent to do. Such a right would render policies of insurance valueless."

While in Illinois there was mere impending danger, in the case at bar, actual and substantial damage had occurred.

A contract of insurance is an agreement to indemnify the insured against loss from contingencies which may or may not occur. When the contingency arises, then and only then does the liability of the insurer become a contractual obligation. Holland v. Caledonian Ins. Co., 149 Fed. Supp. 476; 9 Words & Phrases 109. There then remains no "risk" which could be the subject matter of insurance. The contingency having occurred, there is nothing the insurer can unilaterally do to alter the policy with respect to a loss that is already in being. All that

remains is the determination of the extent of the damage.

> "It is well settled that 'the cancellation of an insurance policy does not affect rights which have already accrued under the policy in favor of the insured or of a third person * * *'. (29 Am. Jur. 261)." Insurance Co. of N.A. v. U.S., 159 F. 2d 699, 701. [131]

The defendant in argument and in its brief recognizes its liability for slippage until the total destruction of the property, or until the present movement ceases and the land again becomes stable, but contends that other risks assumed by the defendant ended upon the notice of cancellation.

With this we cannot agree. It is easily understood why the defendant desires to escape the risk of fire. The hazards of fire are greatly increased by the earth movement and fire protection under the present conditions is at a minimum in the area affected.

The premiums being entire, these contracts of insurance are indivisible, and counsel for defendant so recognizes. (See also C.J.S. 788; Goorberg v. Western Assur. Co., 150 Cal. 510, United States v. Bethlehem Steel Corp., 315 U.S., 289, 298.)

In this case we must remember that the inclusion of "All Physical Loss" provisions in residential fire insurance policies is of recent origin and as a result the case law is very limited. (See "Western Underwriter," April, 1957, page 40.) This court has been faced with the problem of determining the law

without much aid from precedents. The court has endeavored to resolve doubts and ambiguities in the interpretation and construction of the policies in favor of the insured (Calif. Civil Code § 1654; Raulet v. Northwestern Nat. Ins. Co., 157 Cal. 213), and thus prevent the insurer from taking an unjust and unfair advantage of the insured and weaken the purpose for which the policies were issued.

To permit revocation while the contingency insured against is occurring would be to sanction the commission of fraud upon the insured. This court should not be a party to such conduct. [132]

I am therefore of the opinion that the plaintiffs are entitled to a judgment declaring said policies to be in effect until the earth movement has become stabilized, or until the subject matter of the policies has been completely destroyed. The plaintiffs, being given the full continuing protection of the policies, must also continue the burdens imposed thereunder, and continue the payment of premiums. If plaintiffs elect to terminate the said premium payment, the policy shall only cover earth-slide damage.

Counsel for plaintiffs is directed to submit to me, under the rules of this court, proposed findings and decree.

Dated: This 18th day of October, 1957.

/s/ BEN HARRISON,
Judge.

[Endorsed]: Filed October 18, 1957. [133]

In the United States District Court for the Southern District of California, Central Division

No. 249-57—BH

LEONARD F. HARMAN and RUTH V. HARMAN,

Plaintiffs,

vs.

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Defendant.

Findings of Fact, Conclusions of Law and Declaratory Judgment

The within cause having duly come on for trial on July 11, 1957, in the above-entitled court, the Honorable Ben Harrison, Judge, Presiding, and Lyman A. Garber, Esq., appearing as attorney for plaintiffs, Bolton & Groff, by Gene E. Groff, Esq., appearing as attorneys for the defendant, and evidence, both oral and documentary, having been introduced, and the matter having been submitted.

The Court makes the following written Findings of Fact and Conclusions of Law and Judgment Declaration:

Findings of Fact

I.

The plaintiffs commenced the above action in the Superior Court of the State of California in and for the County of Los Angeles. [134]

II.

The Complaint states a controversy wholly between citizens of different states, to wit: between plaintiffs, both citizens and residents of the State of California, and the defendant, American Casualty Company of Reading, Pennsylvania, a citizen and resident of the State of Pennsylvania.

III.

The amount in controversy between the plaintiffs and the defendant exceeds, exclusive of interest and costs, the sum of $3,000.00.

IV.

The defendant duly caused the matter to be removed from the Superior Court of the State of California in and for the County of Los Angeles to the United States District Court, Southern District of California, Central Division.

V.

The defendant issued two policies of insurance, No. HOB16557 and No. 04-500340, to the plaintiffs covering, subject to the terms and conditions of said policies, residential property respectively located at 666 Beachcomber Road, Portuguese Bend Club, Portuguese Bend, Los Angeles County, California, and 669 Seapoint Lane, Portuguese Bend Club, Portuguese Bend, Los Angeles County, California.

VI.

Each of the aforesaid policies were issued on California Standard Form Statutory Fire Insurance Policy and endorsed to cover "All Physical Loss."

VII.

That each of the aforesaid policies provided as follows: "Cancellation of Policy. This policy shall be cancelled at any time at the request of the insured, in which case this company shall, upon demand and surrender of this [135] policy, refund the excess of paid premiums above the customary short rates for the expired time. This policy may be cancelled at any time by this company by giving to the insured a five days' written notice of cancellation with or without tender of the excess of paid premium above the pro rata premium for the expired time, which excess, if not tendered, shall be refunded on demand. Notice of cancellation shall state that said excess premium (if not tendered) will be refunded on demand."

VIII.

The defendant on January 29, 1957, mailed notices of cancellation of each of the above policies stating that the policies would be cancelled February 4, 1957, at 12:00 o'clock noon. Said notices of cancellation were given in accordance with the terms of the policies and counsel so stipulated.

IX.

For several months prior to January 29, 1957, defendant had been aware of the fact that a massive landslide was occurring in the Portuguese Bend Club area of Los Angeles County, that the properties insured under the said policies were in the said landslide area and were suffering progressive

damage therefrom, and that the landslide was still in progress at the time of the mailing of the notices of cancellation.

X.

The risk of damage to the insured property by landslide was one of the hazards insured against under the said policies.

XI.

Monetary adjudication of the amount of damages under the policies was not sought at the trial. Plaintiff stipulated that damages were not total at that time but were substantial, and damage was continuing. Defendant admitted damages estimated at $4,500.00 to 666 Beachcomber Road, and $2,000.00 to 669 Sea Point Lane as of January 26, 1957. Defendant stipulated that the [136] landslide was continuing as of the date of trial.

XII.

Until and unless there is complete destruction of the insured property by landslide, the plaintiffs have substantial property values in the said insured properties subject to risk of destruction by hazards, other than landslide, which are within the scope and the purview of the coverages of said policy contracts.

XIII.

Plaintiffs made an offer of proof of the inability, due to the landslide, of plaintiffs to obtain insurance in the normal insurance markets against hazards, other than landslide, on the properties covered by

the aforesaid policies. Defendant duly objected to the introduction of the evidence referred to. The Court sustained the objection on the grounds that the policy contract was not severable, and that the evidence was incompetent, irrelevant and immaterial.

XIV.

The premiums charged on the respective policies were based upon and stated in said policies on the basis of all hazards insured against, and the premiums stated were not allocated to specific hazards.

XV.

The purported cancellations of the insurance policies was not timely inasmuch as the properties insured, at the time of the service of notices of cancellation, had been materially damaged by the landslide and were patently further endangered by active landslide still in progress.

XVI.

Liability of defendant from past, and from future damage caused by the landslide until the movement stabilizes, is not subject to the condition of plaintiffs paying premiums for periods after the inception of the landslide. [137]

XVII.

The right of the plaintiffs to continued insurance coverage under the said policies against hazards other than landslide is properly subject to their

making timely payment, or tender of premium for periods following that in which the landslide had its inception. The amount of premium payable for each such period is the amount stated in the policies for the period in which the landslide had its inception.

XVIII.

Premiums for the policy periods immediately succeeding the period in which the landslide had its inception have been duly tendered by plaintiffs to defendant, and have been refused. [138]

Conclusions of Law

I.

Plaintiffs should have a binding declaration of Court:

II.

That the said insurance policies are not cancellable while a hostile destructive force insured against, and clearly evident and known to defendant, is operating against the properties; nor while known hostile destructive forces within the limits of hazards insured against are existing or imminent.

III.

That the notices of cancellations are of no force and effect.

IV.

That the respective hazards insured against under the policy contracts are not severable, and the contracts are entire.

V.

That the service of the notices of cancellation were not timely and were not given until the defendant had notice of the occurring landslide condition.

VI.

That no further premiums are due from plaintiff to continue insurance coverage against landslide up to the time that the land stabilizes.

VII.

That timely payment, or tender of premiums for periods subsequent to that in which the landslide took its inception shall be a condition precedent to continuing insurance coverage against hazards other than landslide; that premiums due shall be in the amount charged for the period in which the landslide had its inception; and, conditioned upon said payment or tender of premiums, coverage against hazards other than landslide, shall continue until the landslide stabilizes and shall not terminate on the stated expiration dates of said policies. [139]

VIII.

That the defendant be enjoined from attempting to cancel, claiming to cancel and serving notice of cancellation under the policies, except for failure to tender premiums as herein provided, until further order of the Court; or upon stipulation or written consent of plaintiffs.

IX.

That the Court should retain jurisdiction in this case for a determination of any matters of controversy under the policies.

X.

That plaintiffs should recover their costs of suit.

DECLARATORY JUDGMENT

In accordance with the foregoing Findings of Fact and Conslusions of Law, it is Ordered, Adjudged and Decreed:

1. The notices of cancellation of insurance policies issued by defendant and designated, respectively, No. HOB 16557 and No. 04-500340, mailed on or about January 29, 1957, and stated to be effective February 4, 1957, at 12:00 o'clock Noon, are null and void.

2. The aforesaid insurance policies are in full force and effect and will remain so until the first of the following events shall occur:

(a) It shall be determined by further order of the Court that the landslide at Portuguese Bend on the Palos Verdes Peninsula, County of Los Angeles, State of California, which commenced in the fall of 1956, and has been continuously in progress up to the present time, shall stabilize; and any other insured hazards which had their inception before the permissible termination of the insurance coverage, as above defined, shall have terminated, or

(b) The defendant shall have extinguished, by payment to the plaintiffs, all of the insurance coverage assumed by defendant under the said policies, or either of them, or

(c) The plaintiffs shall give a satisfaction of judgment to defendant, or stipulate in writing to the fact that defendant's duties and liabilities under said policies, or either of them, have been fully met and performed.

3. With respect to hazards, other than landslide, which were assumed by the defendant under the said policies it shall be a condition of future insurance coverage for policy periods after those which included October 1, 1956, that the plaintiffs pay or tender to defendant premiums in the amount established by the policies [141] for the period which included October 1, 1956, for every successive period;

(a) Tender of such premiums for the current installment periods has heretofore been made by plaintiffs and refused by defendant;

(b) It is a condition of continuation of insurance coverage under said policies for hazards other than landslide that said premiums shall be retendered to defendant by plaintiffs within 30 days after the entry of this Declaratory Judgment;

(c) If tender be refused by defendant, plaintiffs may within 60 days after entry of this Declaratory Judgment, if they be so advised, pay the principal amount of such premiums to the Clerk of

this Court, subject to withdrawal on demand by defendant, or refundable to plaintiffs on further order of the Court, and such payment to the Clerk shall be a valid tender of premium due; no interest shall be required;

(d) Future annual installments will be due on the anniversaries of the month and day established by the policy contracts, and if tender be not accepted by defendant, may, if the plaintiffs be so advised, be deposited with the Clerk of this Court within thirty days of such due dates under the provisions aforesaid; and shall be valid tender to keep the policies in effect as to all hazards covered therein;

(e) Coverage against hazards other than landslide may be continued by payment or tender of premiums in the amount and at the times aforesaid until the landslide stabilizes irrespective of the stated expiration dates of the respective policies, except as the policies may terminate as provided in "2" above.

(f) If payment or tender of successive premiums be not made as provided in this section "3," defendant may serve notices of cancellation on plaintiffs as to insurance coverage [142] against all hazards except landslide;

(g) Liability of defendant for all damage caused by said landslide so long as it continues has heretofore been fixed and established by the occurrence of landslide and shall not be subject to the

condition of premium being paid or tendered as aforesaid.

4. Defendant is enjoined from cancelling, claiming to cancel, or serving Notice of Cancellation of its policies HOB 16557 and 03-500340, or both, except as herein provided and permitted.

5. After the occurrence of any of the events defined above in "2" the policies may be cancelled.

6. The Court shall retain the jurisdiction of this matter until final adjustment of the rights and duties of the parties.

7. In the adjustment of any rights and duties of the parties, the parties may seek adjudication thereof by further proceedings in the within cause of action.

8. Plaintiffs shall have judgment against defendant for their costs of suit herein in the sum of $67.35 (Taxed, no obj.).

Dated: November 14, 1957.

/s/ BEN HARRISON,
United States District Court
Judge.

Affidavit of Service by Mail attached.

[Endorsed]: Filed and entered November 14, 1957. [143]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that American Casualty Company of Reading, Pennsylvania, Defendant above named, hereby appeals to the Court of Appeals for the Ninth Circuit from the final judgment entered in this action on November 14, 1957.

Dated: December 12, 1957.

BOLTON AND GROFF,

By /s/ GENE E. GROFF,
Attorney for Defendant and Appellant, American Casualty Company.

Affidavit of Service by Mail attached.

[Endorsed]: Filed December 12, 1957. [145]

In the United States District Court, Southern District of California, Central Division

No. 249-57-Y Civil

LEONARD F. HARMAN and RUTH V. HARMAN,

Plaintiffs,

vs.

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Defendant.

Honorable Ben Harrison, Judge Presiding.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Appearances:

For the Plaintiffs:
LYMAN A. GARBER, ESQ.

For the Defendant:
BOLTON AND GROFF,
GENE E. GROFF, ESQ.

Tuesday, June 11, 1957; 2:00 P.M.

The Clerk: Case No. 249-57-Y, Leonard F. Harman and Ruth V. Harman v. American Casualty Company of Reading, Pennsylvania, for trial.

Mr. Garber: Ready.

Mr. Groff: The defendant is ready, your Honor.

The Court: What facts are you gentlemen prepared to stipulate to?

Mr. Garber: I believe, if it please the Court, there is not very much in dispute on the facts in this matter.

These are two insurance policies, all physical risk, which were issued some two years to a year and a half ago respectively—I may be a little wrong on that—before the situation arose of a landslide in the Palos Verdes area in the Portuguese Bend section of the Palos Verdes Peninsula.

Notice of that was given to the company and I believe is acknowledged by the pleadings. They had full knowledge of the fact of the landslide and of damage as to the degree occurring and to a continuance of the slide, which I guess could be stipulated to is continuing to the present time.

Then we have stipulated that there was service of a 5-day notice of cancellation under each of the policies which were mailed on or about January 29, 1957, and stated to be effective as of February 4, 1957. [4*]

One thing more, your Honor—I have prepared here an instrument which I have labeled "Stipulation of Plaintiffs," relative to the trial of the case.

The Court: I might say that I have not had a chance to study the file or the points and authorities that were filed in the motion for summary judgment, and which I believe was withdrawn by one of the parties at least.

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

Mr. Garber: Your Honor, I believe both sides filed motions and both were denied by Judge Yankwich.

But I think the points and authorities which were filed with those motions would be considered by both parties to be substantially their points and authorities.

The Court: Is not the real issue here as to whether or not cancellation of the policy can be obtained when there is imminent danger?

At the time of the cancellation of the policy, was there any damage to the property?

Mr. Groff: There was, your Honor.

Your Honor, I don't know whether you took my silence as to counsel's statement of a stipulation as being my agreement to the stipulation. I would like to restate what I am willing to stipulate to, if I may.

The Court: You may.

Mr. Groff: And that is, that the policies may go into evidence and they will speak for themselves; [5]

That they were duly executed, they were executed by the companies and premiums were paid for them;

That we received due notice of loss and that an earth movement occurred in the area.

The Court: I think most of us will take almost judicial notice about the trouble that they have been having down at Portuguese Bend.

Mr. Groff: And that that earth movement has continued up to this time.

Beyond that I can think of nothing at the present time that we are willing to stipulate to.

The Court: Can you stipulate as to what extent —not in dollars and cents but as to what extent— the earth movement has affected the premises involved here?

Mr. Groff: I think counsel properly labeled this document as a stipulation on his part, or an agreement of facts on his part. We acknowledged receipt of it, but it wasn't a mutual stipulation between the parties.

We do not know, your Honor, at this time I don't know—I have some idea as to what it was at the date of cancellation—but at the date of cancellation, if I may use that expression with the Court, on the one building there was approximately $2,000 worth of damage, and on the other building I will have to be a little bit broader, it was somewhere between $4,500 and maybe $6,000 worth of damage. That is as of [6] February 4, 1957.

The Court: Then the houses had been partially damaged at the time of notice of cancellation?

Mr. Groff: I will so state.

The Court: Both houses?

Mr. Groff: Yes. I will so state here in Court.

The Court: As I understand, the notice of cancellation was given after this damage had occurred.

Mr. Groff: After there had been notice that there was damage to the building; that is correct, your Honor.

The Court: I think the policies are the first

things that should be introduced in evidence. Who has them?

Mr. Groff: May I make one more statement?

The Court: Yes.

Mr. Groff: I believe that if there is to be any issue I want to put proof on, but I believe the pleadings admit the receipt of the cancellation notice.

The Court: He made a statement that the notice of cancellation was received and mentioned the date it was received.

Mr. Groff: I misunderstood him, then. I thought he said they were mailed and stated to be effective.

The Court: You said he received it and that it became effective, I think, February 4th, did you not?

Mr. Garber: I think I said, your Honor, that they were stated to be effective February 4th. **[7]**

Shouldn't the policies be introduced and also the notice of cancellation?

Mr. Groff: The pleadings admit the cancellation.

The Court: I know, but should I not have that before me?

Mr. Groff: I don't have them. The plaintiff has them.

Mr. Garber: Would you care to examine these, counsel?

Mr. Groff: Yes.

(Counsel examining documents.)

The Court: The stipulation filed with the Court, of course, is only the plaintiff's stipulation.

Mr. Garber: That is correct, your Honor.

The Court: May I ask, is there any dispute of this fact—it says, "This stipulation is predicated upon the following facts"—at the time of the filing of the complaint, plaintiff's had no knowledge of the date upon which the trial of these causes of action would be had. Knowledge of how great the damage to the premises would be at the time of trial quite conceivably could not then have been totaled.

There cannot be much argument about that, can there, counsel?

Mr. Groff: Concerning that, I would say there could be no question.

The Court: You have already made a statement as to the amount, generally speaking, of damages. Was the damage done to the houses? [8]

Mr. Groff: To the houses.

The Court: And that the damage to the premises is not totaled at this time?

Mr. Groff: I will agree to that, your Honor.

The Court: Would you stipulate the landslide is still continuing and is impractical to determine the extent, nature or cause of the engineering work in the buildings which is necessary to be done, or even to ascertain whether or not it is practical to effect repairs of the premises?

Mr. Groff: I will stipulate, your Honor, that as of this time that I am standing before you, that the earth movement is continuing.

The Court: And was at the time the suit was filed?

Mr. Groff: I can stipulate as one occurrence as

to this date. I don't know what is going to happen tomorrow, nor does anybody else.

Now, as to the other matters, I don't care to stipulate, your Honor.

The Court: You do not object to the fact that he is not making claim for money at this time, are you?

Mr. Groff: If that is his theory of the complaint, and he wants to go on that theory, I won't object to it, your Honor.

The Court: What oral evidence do the plaintiffs or the defendant want to introduce in this case? [9]

Mr. Garber: I would like to have Colonel Harman take the stand.

The Court: May I ask, probably as a matter of curiosity, how close were these premises to the edge? I haven't been down there, all I know is what I have read in the papers.

Mr. Garber: These two houses, your Honor, if your Honor is familiar with the area at all, are pretty much a prolongation of the ocean through the clubhouse up the hill, and the two houses stand one above the other. I suppose they are, I imagine, some 200 or 300 feet up the hill from the clubhouse.

The landslide area extends much further up the hill. It goes up some 600 or 700 yards, I guess.

Mr. Groff: Maybe I have been reading the same things that your Honor has, and I was also involved in the Palos Verdes bluff slide, your Honor.

In the case of Portuguese Bend, I think I can

make a statement that we do not have a cliff situation.

The Court: As I understand it from what I have read—as I said before, that is all I know—there has been an earth movement there, that much of that property is gradually shifting into, you might say, the lower areas.

Mr. Groff: That is correct. There are no cliffs involved.

Mr. Garber: It is quite an amazing thing. There are a lot of carriers through California, through the Hollywood [10] Hills, and so forth, probably a hundred thousand homes built on terrain that is much more precipitous than this terrain down here.

The Court: Was this built on filled land?

Mr. Garber: No, your Honor. This is not filled land.

I know part of that slide down there, there is some of the earlier damage, and most of the severe damage is down near the beach where the slope is very modest, but the terrific mass of land from far up the maintain seems to be just a mass coming down and reaching out into some place into the ocean. It has caused a pier to buckle, for example, by the movement of the land.

The Court: Is this part of the property that they claim the building of the highway—I noticed some suits filed by reading of them in the papers—against the County of City because of excavations made that caused the land to shift?

Mr. Garber: That is the theory of the Crenshaw Boulevard area that was involved in cutting the

land loose or something like that. They triggered it in some way.

Fortunately, Mr. Groff and I don't have to battle out that legal proposition.

Mr. Groff: I have about $3,000,000 of it to date, your Honor.

The Court: I think the policies and notice of cancellation should be marked in evidence. [11]

Mr. Garber: I would offer them in evidence.

The Clerk: Are there two policies?

Mr. Garber: There are two policies.

The Clerk: Which one do you want to mark first, or does it make any difference?

Mr. Garber: Suppose you mark the HOB first. I think that is the one I mention first in my pleadings.

The Clerk: I have marked the policy HOB 16557 as Plaintiffs' Exhibit 1, and the other policy I have marked as Plaintiffs' Exhibit 2.

What is this, counsel, a notice of cancellation?

Mr. Garber: A notice of cancellation.

The Clerk: And as Plaintiffs' Exhibit 3 the notice of cancellation.

The Court: Is that the cancellation of both policies?

Mr. Garber: Both policies. There are two cancellation notices, your Honor.

The Clerk: There are four altogether, two by Leonard F. Harman and two by Ruth V. Harman.

Are they all received in evidence, your Honor?

The Court: Yes.

The Clerk: Plaintiffs' Exhibits 1, 2 and 3 in evidence.

(The documents referred to were received in evidence and marked Plaintiffs' Exhibits Nos. 1, 2 and 3 respectively.)

Mr. Garber: Would your Honor care to have the witness [12] take the stand?

LEONARD F. HARMAN

called as a witness in his own behalf, having been first duly sworn, was examined and testified as follows:

The Clerk: What is your name, please?

The Witness: Leonard F. Harman; H-a-r-m-a-n.

Direct Examination

By Mr. Garber:

Q. Colonel Harman, you are one of the plaintiffs in this action, is that correct?

A. Yes, sir.

Q. We have just marked in evidence as Plaintiffs' Exhibit No. 1 an insurance policy numbered HOB 16557. Can you tell us on what premises that policy covers?

A. 666 Beachcomber Road.

Q. Can you tell us the use that is being made of 666 Beachcomber Road?

A. It is a family residence.

Q. You reside there? A. I live there.

Q. Did you build the house yourself?

A. Yes, sir.

(Testimony of Leonard F. Harman.)

Q. When?

A. In 1954 and '55, occupying it in 1955.

Q. Since completion you have occupied those premises, [13] is that correct?

A. Yes, sir.

Q. Now, Policy No. 04-500340 has been marked as Plaintiff's Exhibit No. 2 in evidence. What premises does that cover?

A. That is at 669 Sea Point Lane.

Q. Is that in the general vicinity of No. 666 Beachcomber Drive where you live?

A. It is directly below us and one lot to the west.

Q. What use is being made of No. 669?

A. We built it as an income property, and have it leased.

Q. For residential purposes?

A. For residential purposes and income.

Q. When did you build that, approximately?

A. 1956.

Q. Colonel Harman, at the time you took these two policies of insurance we have referred to, did you know anything about any unstable condition of the land in the Portuguese Bend area of Palos Verdes? A. No, sir.

Q. When did you first gain any knowledge of a landslide in that area?

A. During last October.

Q. That would be October, 1956? [14]

A. October, 1956.

Q. What brought it first to your attention?

(Testimony of Leonard F. Harman.)

A. I heard about a big crack up toward the extension of Crenshaw.

Q. Was that above where your house was?

A. A half mile above, I guess, and out of curiosity I went up to look at it.

Q. And you found a crack in the land there?

A. It was about six feet wide and running more or less east and west several hundred yards.

Q. Would that be parallel to the ocean?

A. Substantially at that point.

Q. What was the next matter of landslide that came to your attention?

A. Funny things started happening to houses, especially down on the waterfront, buckling and shifting in general on their foundations.

Q. When did you first discover the landslide affecting your property?

A. Probably the latter part of October, 1956, last year.

The Court: Just a moment. What was the first thing you noticed of the landslide affecting your property?

The Witness: A crack on the west side of the house just above the foundation, between the foundation and the plate.

The Court: Are these houses built on a plate or on a [15] wooden foundation?

The Witness: Our house, your Honor, is built on reinforced cement pilings, with a grade beam and then a reinforced foundation around it. The property at 669 Sea Point Lane is built on a slab.

(Testimony of Leonard F. Harman.)

It is reinforced heavily with anchoring pylons and a cantilever deck.

Q. (By Mr. Garber): The first damage you noticed was a crack at 666, is that correct?

A. Yes, sir.

Q. What did you do after you discovered that damage with respect to your insurance?

A. I reported it to the agent from whom I had obtained the policy.

Q. Did anything happen as a result of the report that you made to the agent?

A. Not at first. I think the second time I reported it an insurance company sent an adjuster and a contractor, two people, to examine it.

Q. When this adjuster came, did he introduce himself to you as a representative of the American Casualty Company? A. Yes, sir.

Q. Do you know his name?

A. I can't recall it at the moment. I think I have a record at home. [16]

Q. You say he was accompanied by somebody else?

A. Somebody that represented himself as a contractor.

Q. Do you recall that gentleman's name?

A. I don't remember his name. I think I have a record at home.

Q. Did they make an inspection of the premises?

A. Yes, sir.

Q. In your presence? A. Yes, sir.

(Testimony of Leonard F. Harman.)

Q. Did they see the damage which was existing at that time? A. Yes, sir.

Q. What was the damage that you pointed out to them?

A. At that time the cracks had progressed somewhat. There were cracks in other parts of the ramp coming up the garage, and cracks in the foundation in the house down below at 669.

Q. Did they make any further inspection of the premises in that area?

A. I took them on a conducted tour of the whole area, down at the waterfront and all over to houses where the damage was quite evident, some very severe damage on some houses at that time, and up on the hill so that they could see the massive earth crack and where it had taken place.

Q. Did you have any other contact with people representing [17] the American Casualty Insurance Company?

A. During the early part of December this same adjuster from the insurance company came again to inspect the premises.

Q. Colonel Harmon, I don't believe that I had you specify the date that the adjuster, accompanied by the builder, came first to see the premises.

A. That was, as I remember, during November.

Q. November of 1956? A. November.

Q. Did you have more contact with representatives of the American Casualty Company?

A. The same adjuster came in the early part of December and noted that the damage was con-

(Testimony of Leonard F. Harman.)

tinuing, and in the latter part of December, and an engineer representing the company came to make an inspection.

Q. That is the latter part of December?

A. Yes, it was the latter part of December.

The Court: Is there any dispute on these facts, counsel?

Mr. Groff: I think my stipulation pretty well covered this.

The Court: How much damage is there to the property now? Are you still occupying it?

The Witness: I am still occupying the home. It is being [18] occupied under, you might say, some difficult conditions. The tenants in the income property have given me notice they will vacate this month, in a few weeks.

The Court: Any more damage to the foundation of the houses?

The Witness: Oh, yes, sir. We were away for three weeks. My wife couldn't stand the cracks and listening to it and see things happening, so we had to kind of be gone as much as we can but still sort of act as caretakers. So we came back after three weeks and the cracks have extended out further west from the highway in the last three weeks. And another big piece of earth up toward Crenshaw slid down in our absence.

Q. (By Mr. Garber): Colonel Harman, have you made any attempt to obtain fire insurance on your property from any other insurance carriers?

The Court: May I ask, counsel—I notice it is

(Testimony of Leonard F. Harman.)

pleaded—what materiality is that, whether they can get fire insurance from another company or not? Is not this a question of whether you can get liability out of this policy or not?

Mr. Garber: It is, your Honor, but my thought on this is that this policy should be entirely in force and effect as to all it covers.

The Court: But whether you can get other insurance or [19] not, is that not immaterial?

Mr. Garber: I think, your Honor, that the policy is adequate. That is our position.

The Court: Either there is liability under this policy or there is not.

Mr. Garber: There would be liability for all purposes on it. That is my view.

The Court: I think the Court can almost take judicial notice that no insurance company would issue a policy such as this under present conditions.

Mr. Garber: Nor issue one for fire or windstorm or any other hazard, I believe.

The Court: There would not be any question of that, would there, counsel?

Mr. Groff: I was going to object, your Honor, in that I felt it was incompetent, irrelevant and immaterial. So my answer to your question is that, yes, it is difficult to get it there, your Honor, but I make objection to my own answer so far as establishing it as a part of the record, because I don't believe it has anything to do with this case or contributes anything to the issues.

The Court: I feel that way, too.

(Testimony of Leonard F. Harman.)

Mr. Groff: I would like to put in the objection that it is incompetent, irrelevant and immaterial.

The Court: I am going to sustain the objection, because [20] it looks to me, under both the statements of fact in this case and the pleadings, as to whether or not an insurance company, in view of imminent danger, has a right to give this notice of cancellation. I think that is the whole question.

Mr. Garber: Yes.

The Court: When the property is in imminent danger of a loss, whether that provision of the Insurance Code permitting five days' notice from an insurance company under those circumstances can cancel.

Mr. Groff: With the thought of helping the Court and in order that we have a clear position stated, this is a true statement so far as we are concerned, so long as we each understand what "cancellation" means: "Cancellation" means that the company can give this notice of cancellation. As to the effect of cancellation, that may be a different story.

We take a position that you cannot be denied a cancellation under the contract.

That is a true statement, your Honor.

The Court: Cannot be?

Mr. Groff: Cannot be denied under the statute and under the policy. I am using "cancellation" in that term.

The Court: Is it your position that when there

(Testimony of Leonard F. Harman.)

is an imminent danger there you can avoid your liability by giving a 5-day notice?

Mr. Groff: That isn't before us on these issues, your [21] Honor.

The Court: Why isn't it?

Mr. Groff: The position of this complaint, if I understand it correctly, is that if this house burned down today that the cancellation notice would be ineffective for the burning of the house.

Is that your position, counsel?

Mr. Garber: That is my position.

Mr. Groff: That I believe is the position of the complaint.

This is all we are fighting is a complaint as we are faced with it on that issue, and the substance of it, as counsel says it is.

The Court: Are you claiming that fire insurance is still in effect?

Mr. Groff: We say that cancellation is good as far as fire insurance goes.

The Court: This is one of those new gimmicks that the insurance companies have been trying out the last couple of years, is it not?

Mr. Groff: Can I take an honest position with your Honor? This is rather informal, the way we are proceeding here. I do it with the purpose of trying to assist counsel and the Court, if I may.

I am well aware of the cases which have stated that [22] where we have a named peril policy, such as a fire insurance policy—I believe Mr. Garber

(Testimony of Leonard F. Harman.)

cited some, there aren't many, just one or two or something like that—but where we have a fire and that fire commences before an expiration date, that the expiration date doesn't cut off the damages for a subsequent indemnity of fire that started before.

Now the theory of those cases I submit to this Court is one of proximate cause, your Honor, the proximate cause having commenced before the fire.

In this case we have what we call an all physical loss form. I know of no cases, your Honor—and I have tried to find some—in which the issue has been before the Court and been passed on as to the effect of that rule that we may have a proximate cause in connection with an all physical loss.

As to whether there should or shouldn't be a difference, I would like to state this, that the fire policy says we will pay for all damages proximately caused by fire, a named peril.

The APL—all physical loss, if I may use that term; "APL" is what it is known in the business—that is, I believe if I can paraphrase it, that we will pay for all physical loss to the object occurring within the term, the term of the policy being the inception to the expiration date or, as some courts have indicated, inception to date cancelled constituting the term.

I know of no law, I can't say that there is, but I suggest [23] that to you, that there is a difference in coverage.

(Testimony of Leonard F. Harman.)

The Court: Haven't we a rather unique situation here as far as the law is concerned?

Mr. Groff: Yes. And I would say this, that I don't think that you can consider them necessarily both together, in that the broad character of an all physical loss, where you say that damage occurs to this within the term of the policy, that this damage does not have to be triggered by an incident which will be a proximate cause factor that will start and stop. You may have a continuance. It may go on for 15 years.

Projecting this theory of continued liability in instances such as Portuguese Bend, where the Government made a survey in 1922 and another in 1942, and found the condition where there have been houses and areas which have moved for years, now you would write a policy in perpetuity because of the different character of the policy, because of the APL and a named peril fixed incident such as fire which starts in the normal course of human events.

I state that to your Honor only on this basis, that we are before this Court only because it is the position of the plaintiffs, as stated by Mr. Garber, that we may not terminate any liability whatsoever under the policy, that if it burned tomorrow the cancellation is ineffective and we would have to pay for the burning of the building.

That is the only issue that we have to face in this [24] particular lawsuit, and that is the issue that we do face.

The Court: Do you mean to say that if this

(Testimony of Leonard F. Harman.)

property is physically destroyed by something, the earth slide, you are still liable?

Mr. Groff: May I talk outside these pleadings, your honor?

I would say that if that was the issue that we were faced in the pleadings to this complaint originally, my company would have instructed me, if that was the only issue, to say that we were liable for landslide damage starting before the cancellation and continuing as one occurrence into the future beyond the cancellation date. I believe that is what my client would have instructed me to answer.

And counsel has said that that is not the issue in this case.

The Court: I understand the issue to be that counsel is not raising the question of the fire loss that possibly may occur, but it is on account of this special provision of physical loss by reason of this slipping of the earth because it commenced prior to the date of cancellation, and part of the damage had occurred at that time when he called your representatives in to examine the loss.

Mr. Groff: Let me make this general statement: We admit without reservation all loss and damage to February 4, 1957. If I may just get rid of that to start with. That was the date [25] of cancellation.

Secondly, and maybe I misunderstood counsel when I asked him, your Honor, but do I understand, Mr. Garber, that the position of the plaintiffs and do

(Testimony of Leonard F. Harman.)

I understand the pleadings correctly that it is the position of the plaintiffs and the pleadings that we cannot cancel for any purpose whatsoever?

Mr. Garber: Yes, that is the basic pleading.

The basic pleading, of course, was brought to counter the immediate active peril which was then presently confronting the premises on account of the land slipping.

The Court: I might say, if any fire loss occurred there it probably could be sued for under their notice of cancellation, but I think that under the peril having an immediate peril existing there at the time on account of slippage that they would be liable for—I am not making any ruling on this; I am just talking out loud—that the company would be liable for that loss that occurred. If the property is destroyed by reason of that slippage, then the value of those improvements they would be liable for.

Now, where do you and I differ, counsel?

Mr. Groff: We don't differ, your Honor. I take exception to your Honor's statement only in the fact that part of that isn't before this Court at this time. The only thing before us is whether the company can cancel as a total thing.

The Court: It seems to me that it is a difference without [26] a real difference existing between you under your statement. I assume that anybody can get insurance up there for fire loss, I do not know. Probably your company would insure for fire loss right now.

(Testimony of Leonard F. Harman.)

Mr. Garber: I was just going to examine the witness on that subject, your Honor.

The Court: I know, but if it was a straight fire insurance and conditions existed where they could have canceled out the fire insurance, there is no question about it. But it is this special physical damage rider—I do not know whether it is a rider or not; I have not examined the policy—but it is a new provision that has been provided for insurance agents and that they are using now to sell insurance by. That is the issue in this case.

Now it seems to me that if the company recognizes any loss that may occur by reason of this physical damage clause, why, you haven't anything to quarrel about.

Mr. Garber: By "physical damage" you are referring to the landslide?

The Court: Yes. That is the physical damage. The only trouble with you is that the earth did not move fast enough.

Mr. Garber: The situation still confronts this assured that he has two valuable pieces of property in which he has invested substantial amounts of money and he bought insurance to cover them. [27]

Now, the land started to slide and it has done substantial damage so far, and it may do a great deal more damage in the future. But that doesn't obviate the fact that his property might burn today, or tomorrow, or next month, or that an airplane might fall upon his property, or that a windstorm would come along and destroy it.

(Testimony of Leonard F. Harman.)

Now he is not able at the present time to obtain insurance on the other coverages in the policy. I was going to introduce evidence that he tried to obtain other insurance.

The Court: I know, but whether he can obtain fire insurance in other companies has nothing to do with this case. If no insurance company would have issued a fire insurance policy when he built the houses, he wouldn't have had any coverage either.

Mr. Garber: I certainly agree with your Honor on that point, and I am not criticizing any company which does not at this time take on a fire policy, because it is acknowledged underwriting practice not to.

The Court: I know, but he has no imminent peril from fire at this time.

The way I look at this, what little I have heard and read about this case, is that there may be a serious question whether there is an imminent peril and some damage already done by the slide there, and it looks like a continuous affair, that the property eventually would be destroyed by reason [28] of that, that the company might be held liable under that.

But under a provision of the policy for fire I do not see why the company could not cancel that provision.

Mr. Garber: The only reason, your Honor, is that fire insurance is unobtainable on the premises, or any other premises down there, due to the landslide. That is one of the damages. The landslide is

(Testimony of Leonard F. Harman.)

the physical damage or the destruction which it is doing to the houses.

A collateral effect is that it has made these houses not good insurance protection for fire or windstorm or damage by aircraft or any of the other hazards commonly insured against, the reason being this, that underwriters have found that it is not good practice to write fire insurance—just to use one example—upon property where it would be to the economic advantage of the owner to have the property destroyed.

Now that is just a degree of carefulness. Of course you can't be stronger than that. That is good insurance practice, that if you are going to write insurance you write it on a piece of property that the man would rather have intact than he would have it destroyed. That is a basic tenant in the underwriting of insurance.

We are confronted with this situation, that Colonel Harman has two properties there and he probably would be economically benefited if he had fire insurance and those houses [29] were to burn. He wouldn't be subjected in this case to the slow glacial destruction of the houses by landslide.

That being the situation, no company will come forward and write fire insurance on his house or anybody else's house. That is not a reflection on Colonel Harman, it is a recognition of an underwriting principle which has come into effect for one reason only, and that is the landslides, and the insurability of those houses down there is just as

(Testimony of Leonard F. Harman.)

direct and ascertainable as a result of this landslide as the twisting of roofs and the upending of houses and all of the other damages which is available and visible to the eye. You can go to insurance agents and inquire and say, "I would like to have insurance," and they will say, "You can't have it."

The Court: May I ask you the question: Could the court hold that one provision of the policy is good, the cancellation is good for one part of the policy, and not for the other?

Mr. Garber: I would think it would be a strained construction, your Honor, very strained.

Mr. Groff: May I say something?

The Court: Yes.

Mr. Groff: As I understand the cases, your Honor, there is nothing inconsistent with a holding of the court that the cancellation is good. Now if the philosophy of imminent peril applies here, that is an entirely different philosophy. [30]

Under the fire cases it says that since proximate cause of this thing commenced before the cancellation or expiration date that the loss came within the term of the policy. This seems like a very consistent position to me. The cancellation is good. The loss is within the term because it commenced before the term.

The Court: Then do I understand that really what you people are quarreling about here is the cancellation of the fire clause?

Mr. Groff: We take a position that the cancellation is good, your Honor, for all purposes. We state

(Testimony of Leonard F. Harman.)

and recognize that there is a doctrine of imminent peril in connection with liability for damage that commenced before the termination of insurance. I don't think that is what the plaintiff has asked us to meet in this lawsuit.

The plaintiff has gone, if I may put it this way, he has "gone for broke," he has asked for everything. That is the issue we have met.

But I will state to your Honor, that the doctrine of imminent peril exists but it is not a cancellation doctrine, it is a doctrine of liability for companies.

The Court: Then it is your position that if this property should be completely destroyed by that slide down there that you are still liable?

Mr. Groff: May I speak about my personal position and [31] the position of my company, your Honor, not as an insurer in this case? Yes, as long as it is one occurrence. So long as it is one occurrence.

Mr. Garber: Pardon me. This is not clear to me, the distinction between personal and the other.

Mr. Groff: It is not an issue. I take objection to it because it is not an issue in this lawsuit, your Honor.

The Court: Of course the issue is the cancellation of the whole policy.

Mr. Groff: That is right.

Mr. Garber: I think probably I should state at this time, your Honor, just a bit of the history which I can adduce from the witness if the court cares to

(Testimony of Leonard F. Harman.)

have me do it, but I can probably state it myself more briefly.

This matter started out as a cancellation to have been effective about December 19th or December 29th of all further damage from landslide. There was a request made of Colonel Harman and his wife to sign endorsements to the policy which would terminate the insurer's liability for landslide as of December 27th.

Mr. Groff: Your Honor, I object to that. I prefer to have the witness testify, if it is going to be a part of the record, as to what happened.

Mr. Garber: Very well.

Mr. Groff: I will make an opening statement to the court. [32] There was a letter of endorsement sent, your Honor. I believe those speak for themselves. If we are going to have evidence on it, I believe that is the evidence that should go in.

The Court: The only thing is, it seems to me that you people are not very far apart on this thing.

Mr. Groff: May I talk to counsel, your Honor?

The Court: Yes.

(Conference between counsel.)

Mr. Garber: Your Honor, could I get some evidence from the witness on this point?

The Court: Yes.

Q. (By Mr. Garber): Colonel Harman, did you receive from the American Casualty Company some endorsements to the two policies we have been referring to with the request that you sign them?

(Testimony of Leonard F. Harman.)

A. Yes, sir.

Q. I do not have those with me, but I have another endorsement that you received as an accompaniment to a letter dated in January, 1957. Do you recall if those endorsements were similar or not?

A. Yes, sir.

Q. Did the first endorsement which was offered you say, in substance or effect——

The Court: Does not the endorsement speak for itself?

Mr. Garber: It does, your Honor, except that I don't [33] happen to have the original ones here.

The Court: Show it to counsel. Maybe he can stipulate to it.

Mr. Groff: I have stipulated it may go in evidence. It was sent by the company, duly executed, and it may go in evidence.

Q. (By Mr. Garber): Colonel Harman, did you receive a letter from Rathbone, Kind & Seeley dated January 14, 1957? A. Yes, sir.

Q. And there were attached to that some endorsements? A. Yes, sir.

Q. And they are similar in effect to those previously shown to you? A. Yes, sir.

Mr. Garber: I would like to offer this in evidence as Plaintiffs' Exhibit No. 4, I believe.

The Clerk: In evidence, your Honor?

The Court: Admitted.

The Clerk: Plaintiffs' Exhibit No. 4.

(The document referred to was received in evidence and marked Plaintiffs' Exhibit No. 4.)

(Testimony of Leonard F. Harman.)

Mr. Garber: I wonder if your Honor would care to examine those before I continue. They are the two slips at the bottom of the letter. [34]

The Court: You may proceed.

Q. (By Mr. Garber): Now, Colonel Harman, when you received the first endorsements that I have referred to, which we do not have copies of here, what action did you take?

A. I contacted two insurance agencies in San Pedro to see if insurance was available.

Q. You say you contacted——

Mr. Groff: I will object to that as incompetent, irrelevant and immaterial, move that the answer be stricken, in that it doesn't tend to prove or disprove any of the issues here.

The Court: What difference does it make? There is no jury present, counsel.

Mr. Groff: All right. I do object, your Honor.

The Court: I do not think it is material, as far as that is concerned.

Q. (By Mr. Garber): Colonel Harman, what did you do? You mentioned you went to see somebody at San Pedro. State what you did.

The Court: I think that objection is good on that.

Mr. Garber: Your Honor, I believe that that is an issue that we have in this case under paragraph 13 of our complaint.

The Court: I know you made that allegation in your [35] complaint, but I think it is a question of either they have a right to cancel this policy or not.

(Testimony of Leonard F. Harman.)

Mr. Garber: I would agree with your Honor, if I understand it correctly, and that is if the policy is not canceled it is totally in effect and it is in effect as far as falling aircraft is concerned, as far as fire insurance is concerned, as far as windstorm damage is concerned and as far as any of the other hazards are concerned.

That is the position which I think is correct, that we have a policy which is indivisible, that there is an existing peril, hostile destruction forces at work, or one of them, and that is the landslide. Therefore the policy must remain in the status quo while this hazard exists, and the status quo includes not only the policies covering against landslide, the status quo also embraces within it the other elements of danger which are covered in this policy.

The Court: That is one of the principal issues in the case.

Mr. Garber: Yes, I believe it is, your Honor.

And it is rather a novel issue as far as previous decisions of courts are concerned, because we have in the past, particularly in the field of fire insurance, dealt generally with one destructive force and not with several, although there are some parallels in the cases.

The Court: They are covering now everything but automobile [36] damage, are they not?

Mr. Garber: Yes, they are. As a matter of fact, the policies are a vast improvement, and I think the companies who developed them deserve kudos be-

(Testimony of Leonard F. Harman.)

cause, after all, what an assurer is looking for when he buys insurance is not a guess on what is going to destroy his property, but he wants to be assured that if it is destroyed he will be refunded the value of the perils insured against it.

The only point of this line of this line of testimony was to establish factually the tie-in.

The Court: I do not think it makes any difference whether he can get insurance from some other company or not in this case. This is the only policy that the defendant is involved in. And whether any other company would accept the risk or not, I do not see that it is material to this case, or any part of the risk.

Mr. Garber: If the policy should be in effect then he should be able to rely on the one premium which he has paid for this policy and that should see him through.

The Court: Does that not bring us down more or less to this question, whether a cancellation or any imminent peril is in view or in prospect, whether only the peril that is in prospect can still exist?

Mr. Garber: That is the key of it.

The Court: I presume that the Colonel here is principally [37] interested right now in the earth slide, he is not worrying about a fire burning up his house.

Mr. Garber: We had quite a debate when we got these endorsements as to what to do because most people don't want to be without fire insurance, and that is one of the main motivations in buying the

(Testimony of Leonard F. Harman.)

policy, and he didn't know anything about a landslide at that time.

The Court: Right now I think he is worrying about landslides.

Mr. Garber: But I would think in an all physical risk policy, if you had a fire that started in one side of the building and an airplane hit the other side of the building, that both of those are covered, and a landside starting at the same time that also is covered, and there is no termination of the policy until the last one of those destructive forces is gone.

The Court: That is one of the questions I am going to have you gentlemen brief. I want to say right now that I am not going to decide this case this afternoon. This represents a rather novel point to me.

Mr. Garber: It does. I have always heard about issues that were de novo and I believe that this one is.

The Court: Any further questions of this witness?

Mr. Garber: I have no further questions.

The Court: Do you have any questions? [38]

Mr. Groff: Yes, your Honor.

Your Honor, may I make inquiry as to that exhibit number, the last one that went in?

The Clerk: Plaintiffs' Exhibit No. 4.

(Testimony of Leonard F. Harman.)

Cross-Examination

By Mr. Groff:

Q. Mr. Harman, Exhibit No. 4, you received that, didn't you? A. Yes, sir.

Q. And you read it, didn't you?

A. Yes, sir.

Q. I would like to call your particular attention to the second paragraph which reads:

"It would be quite obvious that we would be in no position to change anything which has occurred prior to the date on which such limitation is made in the policies."

Now, you recall reading that portion also, don't you? A. Yes.

Q. Now, Colonel, you did not understand by the whole of that letter and by that paragraph that the company would not pay you for landslide damage, did you? A. (Pause.)

Q. I know the Colonel doesn't hear too well.

Did you hear me? [39]

A. Yes, but I don't understand the meaning of that.

When they send something like this, whatever that says, when they send this endorsement for me to sign and requesting that I sign that endorsement I would have no coverage for the landslide that was then taking place.

The Court: Isn't that quite obvious from the letter, counsel, what is meant?

(Testimony of Leonard F. Harman.)

Mr. Groff: I don't think it is, your Honor.

The Court: The way I read that letter——

Mr. Groff: This wasn't the position taken by the company and the letter is unfortunately written, but it was not the position taken by the company before the lawsuit was filed.

The Court: Certainly a casual reading of this letter indicates that they are willing to carry the fire loss if he waives his landslide loss.

Q. (By Mr. Groff): Colonel Harman, after you received that letter did you make any further inquiry of the company or any representative as to the meaning of the second paragraph of that letter, or the endorsement, before you filed suit?

A. No, sir. I lost no time in contacting competent people to advise me in such a serious matter as all my life's savings tied up in two houses. It was a very serious matter. I had no time to look around or fuss with the words that they [40] sent.

Q. At any time did anyone connected with the company, excluding this letter for whatever it says, did they ever tell you that they would not pay you for the landslide damage which had occurred and which continued after the cancellation date?

A. Why, yes, by their actions.

Q. You are speaking of the Exhibit 4 that is in front of you, is that correct?

A. I am speaking of this (indicating) and I am speaking of the cancellation notices.

Q. There were no other actions by the company

(Testimony of Leonard F. Harman.)

by which they stated to you they would not pay for the landslide damage, is that correct?

A. They just handed me a knife to hurt myself but they didn't jab it into me.

Q. The form of the question may be unfortunate. Let me restate it.

The Court: Let me ask him this: At any time did you receive any communication from the company or a representative, outside of these letters, relative to the cancellation of this one provision? When you received that letter did you ever talk to anybody connected with the company?

The Witness: No, only my lawyer.

The Court: Only your lawyer? [41]

The Witness: My attorney. I thought it had gone by my ability to handle it.

Q. (By Mr. Groff): Then, outside of the cancellation notice in this letter, there were no other communications, written or oral, from the company that indicated to you that they would not pay for the landslide damage, is that correct?

A. That is correct.

Mr. Groff: I have no further questions.

The Court: I think that is all.

(Witness excused.)

The Court: Any other witness?

Mr. Garber: May I be sworn, your Honor?

LYMAN A. GARBER

called as a witness by and on behalf of the plaintiffs, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name, please?

The Witness: Lyman A. Garber.

Direct Examination

The Witness: I am the attorney for the plaintiffs herein.

On or about January 21, 1957——

Mr. Groff: Your Honor, I think at this time I am going to object unless there is some kind of foundation. This is a bit unusual, I believe, your Honor. [42]

The Court: It may be unusual, but let us hear what he has to say.

Mr. Groff: Subject to my objection, your Honor?

The Court: Yes.

The Witness: On or about January 21, 1957, I telephoned a Mr. Wright, whom I had been informed by the agent was the assistant manager of Rathbone, King & Seely, the general agents for the defendant company, and he told me that it was necessary for them to terminate the coverage on landslides, that that was too expensive for them, but they were willing to stay on the fire.

Subject to that, some three or four days later, I went to the offices of Rathbone, King & Seeley and I saw Mr. Walker, and discussed with him the proposition and clearly understood——

(Testimony of Lyman A. Garber.)

The Court: It is not a question of what you understood. What was said? What your understanding is, is a matter for us to say.

The Witness: He said that as far as he knew the company would not continue on the policy if they had to pay for future landslide damage and that they would endorse the policy either to terminate the landslide damage or would have to get off of it. And that was the best of his knowledge on the situation.

I have no further questions.

The Court: Any questions, counsel? [42-A]

Cross-Examination

By Mr. Groff:

Q. Mr. Garber, what date was it that you stated that you went to see the company?

The Court: He said on or about January 21st of this year.

Q. (By Mr. Groff): At that time, Mr. Garber, what you discussed with him was whether the company was interested in buying the two houses, wasn't it?

A. No. This was a telephone conversation with Mr. Wright on January 21st.

Q. Then you stated you went to see Mr. Walker.

A. Yes.

Q. When did you see Mr. Walker?

A. Two or three days later, I believe.

Q. You went on——

(Testimony of Lyman A. Garber.)

A. The 23rd of January.

Q. And you went to see Mr. Walker following a letter that you wrote to him in connection with a proposal whereby the company would buy the houses from Colonel Harman?

A. Yes, I may have discussed that with him at that time.

Was that letter dated before then? I have forgotten. That was a letter in which I was pointing out a means of [43] salvage to the company.

Q. Yes. I show you this letter dated January 22nd. A. (Examining exhibit): Yes.

Q. That, Mr. Garber, was substantially what you went to see Mr. Walker about on the 23rd, wasn't it?

A. My office is in Bevery Hills, and I was downtown, and I was interested in the case, and I dropped in to see Mr. Wright or anybody else, and Mr. Walker was the only executive present.

Q. The matters contained in this letter are substantially what you discussed with him?

A. Yes, I discussed that with him, I believe.

Mr. Groff: I wonder if I may introduce that, your Honor?

The Clerk: Defendant's Exhibit A.

(The document referred to was received in evidence and marked Defendant's Exhibit A.)

Mr. Groff: I have no further questions.

The Court: That is all.

(Witness excused.)

The Court: Call your next witness.

Mr. Garber: We have no further witnesses, your Honor. The plaintiffs rest.

Mr. Groff: Your Honor, we have but one witness and I offer either the statement as to what the witness would testify to, or the witness himself, just to see if we can shorten [44] this matter.

The witness is Mr. Metcalf. He examined the place about January 26th, and at that time made an inspection, and his estimate as to the damage at that time to the building at 666 Beachcomber Road was $4,500 to $6,000 and at 669 Sea Point Lane approximately $2,000.

I would like to do it this way and ask counsel whether he cares to make such a stipulation that he would so testify.

The Court: That he would so testify?

Mr. Garber: I will so stipulate, your Honor.

Mr. Groff: The defendant rests, your Honor.

The Court: Gentlemen, this case is going to have to be briefed. You just started your troubles and my troubles will start when I get your briefs.

I might say that there ought to be a way that this matter can be solved between you, because your statements here have indicated that the only real difference is that of the carrying of the fire loss.

Mr. Groff: That is substantially correct, but with your Honor's permission may I state it differently?

Our position is that so far as landslide liability is concerned, so long as it is a continuing occurrence,

it is not affected by the cancellation. If I may put it that way, your Honor, I will agree.

The Court: I am taking just the two features of the [45] policy that the parties seem to be concerned about. First is fire and landslide damage, and that has already commenced, it is already in progress.

Mr. Groff: I think a better statement, if I may say so to the court, is that it is liability arising out of landslide and all other liability from any other cause. I think that is a truer statement of counsel's position, your Honor.

Is that not true?

Mr. Garber: Yes. I think the court is probably using "fire" as a generic term, but it covers windstorm and all of the things which are not currently happening.

Mr. Groff: That is our position, your Honor.

The Court: And of course your position is that the landslide having commenced, if the landslide destroys the property, you are still liable? Is that not your position?

Mr. Groff: Your Honor, I am going to give you a square answer if I can have two seconds with my client.

(Conference between counsel and client.)

The Court: You can answer that yes or no. I just want to know your position.

Mr. Groff: On these pleadings, no.

The Court: On the pleadings, no?

Mr. Groff: On these pleadings, no.

The Court: They can always be amended to conform to facts. [46]

Mr. Groff: Then we would have admitted it if we had been served with such pleadings, we could have admitted that when we came in.

The Court: As we try it now, what are the facts?

Mr. Groff: I have only advised my client in connection with these pleadings. Mr. Walker and myself are inclined to do that at the present time.

If I may have a half an hour I can call his superior and ask him, your Honor. I don't feel that it is something I should stipulate to in open court without direct authority.

The Court: We cannot take a recesss until you communicate with the head office every time a question comes up, counsel, so I will not ask for it.

You do claim that all other losses have been cancelled out?

Mr. Groff: I do claim that, and I am neutral, if I can it this way, at this point, and I will advise counsel and your Honor by letter as soon as I can communicate with them.

The Court: I do not know anything about this company, whether it is a big company or not, but it seems to me that shenanigans of some kind are going on where a matter like this cannot be adjusted.

Mr. Groff: Had you planned to recess now, your Honor?

The Court: I am planning on going home pretty soon. I will take it up tomorrow morning. [47]

Mr. Groff: Maybe we can save ourselves some

time. We will admit to the entry of judgment, your Honor, on proper pleadings: (1) That there was a cancellation as of February 4, 1957, of the whole of each of the policies; (2) that that cancellation does not affect the liability of the defendant for damage by a landslide commenced before February 4, 1957, and continuing after that date as one occurrence.

The Court: What does counsel have to say about that?

Mr. Garber: That covers one point, your Honor, the situation with respect to the landslide, but I am afraid the use of the word "cancellation" in there would be destructive of plaintiffs' position because cancellation would mean——

The Court: I do not think the language he used conveys his full meaning, that the policy was cancelled but there is a liability before the cancellation that had commenced and is a continuing liability until that present condition ceases.

Mr. Garber: Your Honor, I do not believe that cancellation is something which is possible at this stage of the proceedings, or where they were when the notices were served.

The Court: You know, counsel, half a loaf is better than no loaf.

Mr. Garber: Your Honor, we had to make this decision, as to whether we should have fire insurance and no landslide insurance or whether we would try to keep the landslide insurance which was the present risk, to keep that applicable. [48]

The Court: That is your imminent danger right now. That is the real worry of the parties.

Mr. Garber: Well, it is, but we have no guarantee against other casualties not occurring.

The Court: You have no guarantee you will be here tomorrow either.

Mr. Garber: No. But we haven't paid a premium on that.

The Court: It seems to me that you are close enough together that you ought to be able to work this out. We have so few cases involving fire insurance companies that most of their losses are recognized. We do not have more than probably half a dozen cases in the whole District in a year that I know of. And they could not write any insurance unless they paid losses, people just would not buy insurance, and they seem to think they have a bad risk in this case, which no doubt is true.

Mr. Garber: Before I started practicing law I was a special agent for the Great American Fire Insurance Company, and I am well aware, and really have my heart very much in this case because of my respect for the fire insurance companies and the standards which they generally adhere to, and their meticulous obligations of their liability.

The Court: Have you people discussed this together and tried to get it straightened out?

Mr. Garber: Yes, we have, your Honor.

Mr. Groff: May I, with counsel's permission, state to you——

The Court: I might say to both of you that I am very [49] much in sympathy with the plaintiffs' position in this case.

Mr. Groff: We have already so stated to counsel on previous occasions, your Honor.

The Court: What is that?

Mr. Groff: We have stated our position to counsel on previous occasions.

The Court: You do not feel that further discussion would be of any value? Both of you are in this position, that you may get a whole loaf or you may not get any loaf, and I will include both of you. I am saying that because I do not know too much about it. I just got this file and had merely a chance to glance through it and haven't had the occasion to do any researching on the subject. But I can see you have a problem on your hands, both of you have, and so has the colonel here a problem on his hands.

Mr. Groff: Your Honor, we have stated our position. If counsel has anything he wishes to state here, I realize that it might take time for him to discuss it with his client, but we are certainly going to listen to him. We have gone forward and stated our position.

Mr. Garber: Our position I think is quite simple.

The Court: You want everything for nothing.

Mr. Garber: That is our position.

The Court: That is your position, everything or nothing.

Mr. Garber: We can't afford to take a gamble on, say, [50] the remaining $30,000 or $35,000 in these houses going up in smoke, and they could very well go up in smoke. The only fire protection is a

county road which is closed, and I don't know if they could get a fire engine up the hill. It is a real hazard, and it would be very difficult if we did have a fire there to make any major part of our recovery out of the land damage at this time.

The Court: How long do you want to brief this case? I will give you 30 and 30.

Mr. Goff: If counsel can get his in in 30 days I can get mine in.

The Court: Simultaneous briefs will be due in 30 days.

Mr. Garber: We can make it quicker, if possible. The reason I say that is because I will certainly advance to the limit of my ability any date because of the anxiety of these parties to have this matter clarified.

The Court: If you have a fire loss in the meantime you will have another lawsuit.

Mr. Garber: 15 or 20 days would suit me if it would suit counsel.

The Court: The only thing is, you must remember after you get your briefs in I have to do some work too, and I have some briefs ahead of you now.

Mr. Groff: If that is a factor in your Honor's getting to ours, I would appreciate the 30 days, your Honor. [51]

The Court: 30 days simultaneous briefs. Then at the end if either one of you wants to answer the other's brief and will make a request I will probably give you a few days to do that.

Mr. Garber: Thank you, your Honor.

(Whereupon, at 3:25 o'clock p.m., court was adjourned.) [52]

Certificate

I hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled cause on the date or dates specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 14th day of June, A.D. 1957.

/s/ AGNAR WAHLBERG,
Official Reporter.

[Endorsed]: Filed December 19, 1957. [53]

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 148, inclusive, containing the original:

Petition for Removal.

Copy of all Processes, etc., served upon Defendant.

Notice of Filing Petition for Removal of Cause.

Notice of Motion for Summary Judgment, filed 2/20/57.

Motion for Summary Judgment, filed 2/20/57.

Memorandum of Points and Authorities in Support of Motion for Summary Judgment.

Proposed Findings of Fact, etc.

Proposed Judgment.

Supplementary Affidavit of J. H. Walker in Support of Motion for Summary Judgment.

First Amended Complaint, filed 3/6/57.

Plaintiff's Points and Authorities supporting Summary Judgment for Plaintiffs, etc.

Statement of Genuine Issues.

Minute Order—3/11/57.

Notice of Motion and Motion for Summary Judgment, filed 4/2/57.

Notice of Motion for Summary Judgment for Plaintiffs, etc., filed 4/5/57.

Statement of Genuine Issues.

Minute Order—4/15/57.

Answer to First Amended Complaint.

Minute Order—6/11/57.

Stipulation by Plaintiffs Re Issues for Trial.

Notice of Motion and Motion to Vacate Submission for Offer of Proof and Order.

Minute Order—7/15/57.

Stipulation to Vacate Submission for Offer of Proof and Order.

Minute Order, 9/4/57 and 10/14/57.

Stipulation re: correction Reporter's Transcript.

Opinion of Court.

Findings of Fact, Conclusions of Law and Declaratory Judgment.

Notice of Appeal.

Designation of Contents of Record on Appeal.

B. Plaintiff's Exhibit 1, 2, 3 and 4.
Defendant's Exhibit A.

C. One volume of Reporter's Official Transcript for proceedings had on: June 11, 1957.

I further certify that my fee for preparing the foregoing record, amounting to $1.60 has been paid by appellant.

Dated: December 30, 1957.

[Seal] JOHN A. CHILDRESS,
Clerk;

By /s/ WM. A. WHITE,
Deputy Clerk.

[Endorsed]: No. 15849. United States Court of Appeals for the Ninth Circuit. American Casualty Company of Reading, Pennsylvania, Appellant, vs. Leonard F. Harman and Ruth V. Harman, Appellees. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed December 31, 1957.

Docketed: January 15, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15849

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA, a corporation,

Appellant,

vs.

LEONARD F. HARMAN and RUTH V. HARMAN,

Appellees.

STATEMENT OF POINTS

I.

A concise statement of the points on which appellant intends to rely on this appeal is as follows:

1. Insufficiency of the evidence to support the findings of fact.

2. Inconsistency between the several findings of fact.

3. Failure to find upon material issues.

4. Making of alleged findings of fact upon matters beyond the issues and beyond the powers of the Court.

5. Ambiguity and uncertainty in the findings of fact.

6. Insufficiency of the findings of fact to support the conclusions of law and the judgment.

7. Inconsistency between the several conclusions of law, and between the conclusions of law and the findings of fact.

8. Making of alleged conclusions of law upon matters beyond the issues and beyond the powers of the Court.

9. Ambiguity and uncertainty in the conclusions of law.

10. Failure to state separately or to properly distinguish between findings of fact and conclusions of law.

11. Errors of law in the conclusions of law.

12. Error in rendering judgment in favor of appellees and against appellant.

13. Errors of law in the judgment.

14. Inconsistency between the several parts of the judgment, and between the judgment and the conclusions of law and findings of fact.

15. Ambiguity and uncertainty in the judgment.

16. Adjudication of matters beyond the issues and beyond the powers of the Court.

Dated: San Francisco, 18 February, 1958.

BOLTON & GROFF,
LONG & LEVIT,

By /s/ BERT W. LEVIT,
Attorneys for Appellant.

[Endorsed]: Filed February 19, 1958.

No. 15,849

IN THE

United States Court of Appeals

For the Ninth Circuit

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,
Appellant,

vs.

LEONARD F. HARMAN and RUTH V. HARMAN,
Appellees.

APPELLANT'S OPENING BRIEF

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Subject Index

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No. 15,849

IN THE

United States Court of Appeals

For the Ninth Circuit

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,	*Appellant,*
vs.	
LEONARD F. HARMAN and RUTH V. HARMAN,	*Appellees.*

APPELLANT'S OPENING BRIEF

JURISDICTIONAL STATEMENT

Appellees (plaintiffs) commenced this action in the Superior Court of the State of California, County of Los Angeles, by complaint for declaratory relief against appellant (defendant). Appellant removed the cause, by reason of diversity of citizenship, to the District Court for the Southern District of California, Central Division; the amount in controversy exceeds $3000. After removal an amended complaint was filed in the District Court [R 3-14]. This appeal is from a final judgment rendered after trial by the Court sitting without a jury [R 35-38; 39].

Jurisdiction of this cause is conferred on the District Court by 28 *USC* §1332 and §2201. Jurisdiction

to review the judgment herein is conferred upon this Court by 28 *USC* §1291 and §1294 (and see §2201).

STATEMENT OF CASE

Appellees (husband and wife) owned two dwellings at Portuguese Bend, California; they resided in one, and rented the other to a tenant [R 49-50]. Appellant issued two policies of insurance to appellees, each covering on one of the buildings and its contents [Ex 1, on the dwelling occupied by appellees; Ex 2, on the rented dwelling]. While the policies were not identical in form, in general each covered its described dwelling against "all physical loss", and the contents against loss by fire, landslide, and other specified perils. Each policy contained the usual clause permitting the insurer to cancel the policy at any time upon specified notice.

In October 1956, while the policies were in force, a large earth movement or slide occurred in the area and caused cracks to appear in the insured buildings [R 50-52]. The slide and damage were progressive [R 53], and were still continuing at the time of the trial in June 1957 [R 45, 54]. Notice of the damage being caused by the slide was promptly given to appellant by appellees [R 52], and appellant inspected the property in November and again in December of 1956 [R 52-54].

By written notices of cancellation [Ex 3], appellant attempted to cancel both policies as of 4 February

1957. It is the effectiveness and validity of these cancellation notices that is involved in this action.

On 4 February 1957 appellees commenced this action. Their amended complaint prays [R 13] for a money judgment for the full face amount of both policies, for certain injunctive relief, and for a declaration that the cancellation notices were of no validity by reason of the existing slide condition and that the policies would remain in full force as to all hazards insured against until the ultimate cessation of the landslide. At the trial appellees conceded that the loss to that time was not total to insurance, and they did not ask for any money judgment [R 20].

The declaratory judgment rendered by the trial court [R 35-38] decreed as follows:

(1) The cancellation notices were "null and void" [R 35, ¶1];

(2) Both policies shall continue to remain in full force and effect until (a) the Court makes a further order that the landslide has terminated, or (b) appellant shall have paid to appellees the full face amount of both policies, or (c) appellees shall have stipulated in writing that all policy obligations have been fully performed by appellant [R 35-36, ¶2],—after any of these events have occurred "the policies may be cancelled" [R 38, ¶5];

(3) Policy coverage for landslide damage shall continue, regardless of expiration dates of the policies and without further payment of premium, as long as the landslide continues [R 37-38, ¶3g];

(4) Policy coverage for all other hazards insured against shall continue, regardless of expiration dates of the policies, subject only to continued payment or tender of premiums by appellees for as long as the policies remain in full force and effect under ¶2 [R 36-37, ¶3,a-e], and if such payment or tender of premiums is not made appellant "may serve notices of cancellation on [appellees] as to insurance coverage against all hazards except landslide" [R 37, ¶3,f]; and

(5) Appellant is enjoined from cancelling or attempting to cancel its policies except as specifically provided in the judgment [R 38, ¶4].

Appellant conceded at the trial (and agrees now) that the cancellation notices did not have any effect on appellant's liability for landslide damage from the slide going on when the cancellation notices were served, and that appellant is liable for such damage as though no cancellation notices had been served [R 59-61, 65-66, 79-82].

The case turns here, as it did below, upon a record consisting mainly of documentary evidence plus a minor amount of oral testimony, as to all of which there is no substantial factual conflict.

SPECIFICATION OF ERRORS

I.

A. Finding XV [R 32] to the effect that the cancellations were "not timely" because at the time of service of the notices of cancellation the properties had

been damaged by and were still endangered from a continuing landslide, is clearly erroneous.

B. The Court erred in concluding and adjudging that the cancellation notices were of no force or effect and were null and void [Conclusion III, R 33; Judgment ¶1, R 35]; and in concluding that the policies were "not cancellable" while the landslide was in progress or while further damage from it was "imminent" [Conclusion II, R 33]; and in concluding that the notices of cancellation were "not timely" because not given until after appellant had notice of the existing landslide condition [Conclusion V, R 34].

C. The Court erred in concluding that the hazards insured against were not severable and that the contracts were entire [Conclusion IV, R 33], with respect to the right of appellant to exercise its contractual right of cancellation as to all losses and hazards excepting damage already caused or that might thereafter be caused by the then existing landslide condition.

II.

A. Findings XVI and XVII [R 32-33] to the effect that appellees have a "right" to continued insurance coverage under the policies (1) for hazards other than landslide (a) after the effective date of cancellation stated in the cancellation notices, and (b) after the dates of expiration stated in the policies by continuing to pay or tender to pay additional premiums; and (2) for the existing landslide, after the dates of expiration stated in the policies—are clearly erroneous.

B. The Court erred in concluding and adjudging that the policies could be continued in force after the expiration dates stated in the policies, for perils other than landslide, at the option of appellees by payment or tender of future premiums [Conclusion VII, R 34; Judgment ¶3, R 36-37]; and that even after default in such payment or tender the policies would remain in force unless cancelled by appellant [Judgment ¶3,f, R 37].

C. The Court erred in concluding and adjudging that the policies would continue in force after the expiration dates stated in the policies for the existing landslide peril, however long it might continue [Judgment ¶3,g, R 37-38].

D. The Court erred in adjudging (1) that the policies will remain in full force and effect until either (a) it is determined by further order of the Court that the existing landslide has "stabilized" and that "any other insured hazards which had their inception before the permissible termination of the insurance coverage" shall have terminated, or (b) appellant shall have paid to appellees the full face amount of both policies, or (c) appellees give to appellant "a satisfaction of judgment" or a written "stipulation" that appellant has fully performed all of its policy obligations [Judgment ¶2, R 35-36]; and (2) that even thereafter the policies would remain in force unless cancelled by appellant [Judgment ¶5, R 38].

III.

The Court erred in enjoining appellant from cancelling "claiming to cancel", or serving notices of cancellation of the policies [Conclusion VIII, R 34; Judgment ¶4, R 38].

ARGUMENT

The entire problem in this case revolves around the answer to one legal inquiry: What is the effect of an existing (and continuing) loss condition upon the insurer's right, granted by policy provision, to cancel the policy?

There are two closely related questions which have been dealt with by the courts: (1) What if there is no *existing* loss condition, but rather a condition that *threatens* to cause loss to the insured property? (2) What if the policy, instead of being cancelled, is about to expire or terminate by virtue of its own provisions?[1]

Because only a single point of law in a rather limited field is involved and because the decided cases are relatively few, we have chosen to review the present state of the law first [Argument, I], and then to treat of the application of the established rules to the case at bar [Argument, II]. We hope that this will make for clarity and simplicity.

---

[1]When we speak of "loss" or "loss condition" we refer, of course, to the consequences of a peril insured against by the policy.

I. THE AUTHORITIES.

A. LOSSES AFTER POLICY EXPIRATION.

1. Liability policies.

The problem of liability for a loss which occurs, after expiration of the policy term, from a cause of loss that is covered by the policy and became operative while the policy was in effect, is one that arises in connection with liability policies as well as property damage policies.

Perhaps the outstanding case on this subject is *Export SS Corp v American Ins Co* (CA 2, 1939) 106 F2 9. The owner of a steamship took out a policy of marine insurance with Company A covering loss arising from liability for damage to cargo; the policy term ran from 20 February 1936 to 20 February 1937. The owner later obtained an identical policy written by Company B which ran from 20 February 1937 to 20 February 1938. During January 1937 the ship took on tobacco, which it stored next to some valonia. When the ship was unloaded on 13 March 1937 it was discovered that the tobacco had been seriously damaged by heat and moisture from the valonia. The insured shipowner paid the cargo owner, and then sued both his insurers. The trial court found that substantial damage had occurred to the tobacco during the term of Policy A (that is, by 20 February 1937); and it held Company A liable for the entire loss whether occurring before or after that date, and held that Company B was not liable at all. The trial court felt that the controlling consideration was that Policy A was in force when the act causing the damage (namely, bad storage location) had taken place and when the first damage occurred.

The judgment was reversed on appeal. The court held that Company A was liable only for that part of the damage that occurred during the term of its policy, and that Company B was liable for all damage occurring during the term of its policy. In holding that each insurer was so liable, the court said [p10-11]:

> ". . . The insurer has no obligation as to losses from liabilities accruing before or after the term. The time of accrual of the insured's liability is the determining factor, not the time of an event which ultimately results in liability . . . *So too with insurance against loss of property.* The insurer must respond for the loss sustained *during the term* from the causes insured against, and to ascertain what that loss was later developments may be looked at. But the policy does *not* cover loss incurred *after the term, however inevitable the loss may have been from causes operating during the term.* [Cits] . . .
>
> In *fire insurance cases* there is a *departure* from the general rule. It is held that if the policy expires after fire has commenced to burn the property insured, and the fire is a continuous one extending beyond the period of insurance, the insurer is liable for the entire loss. [Cits] Separation of the loss, it is said, would be impossible as a practical matter, any attempted division resting on a mere guess. So the fire is deemed one event, taking place when the fire touches the insured property. [Cit] The rule works to the advantage of the insured . . . The courts have refused to extend the rule to a case where the fire has not yet touched the insured property at the

> expiration of the contract of insurance, although its destruction by fire raging in adjoining property may then be inevitable. In such cases the general principle is followed that the insurer is not liable for a loss occurring after the period covered. [Cits]"[2]

The opinion notes that the infliction of the damage to the tobacco was not a single event; heat and moisture from the valonia flowed to the tobacco for more than a month. There was evidence that 26% of the total damage had occurred by expiration of Policy A, and that the balance occurred during the term of Policy B. Company A argued that the other insurer should pay the entire loss, because there was no liability until 13 March 1937 when the failure to make delivery of the tobacco in good condition occurred. The court rejected this, noting that a cause of action had arisen before expiration of Company A's policy for the damage done up to that point. The court held Company A liable for 26% of the loss, and Company B for 74%.

For California cases involving liability policies and reaching results similar to the *Export SS* case, see:

Remmer v Glens Falls Indem Co (1956) 140 CA2 84, 295 P2 19;

Protex-A-Kar Co v Hartford Ad'I Co (1951) 102 CA2 408, 227 P2 509;

Tulare County Power Co v Pacific Surety Co (1919) 181 C 489, 185 P 399.

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[2]Emphasis ours throughout this brief, unless otherwise noted.

An annotation in 45 ALR2 999 (1956), dealing with products liability insurance, points out that conflicting decisions on whether losses under liability policies occurring after expiration of the policy are covered or not often turn upon the specific language contained in the policy in suit.

2. Fire policies, generally.

Turning to the fire insurance field, we shall first consider the leading case of *Rochester etc Ins Co v Peaslee-Gaulbert Co* (Ky 1905) 1 LRANS 364, 9 AmCas 324. In that case the fire started on the insured premises within a few minutes of the "noon" which was specified in the policy as the time of expiration.[3] The trial court instructed the jury that if it found that the fire started to burn in the insured buildings *after* "noon" but was burning before noon in adjacent premises to such an extent that the destruction of the insured buildings was inevitable before noon, then recovery could be had under the policy. This instruction was held to be error, the court saying [1 LRANS, 369]:

> "The risk assumed by the insurer was that of loss or damage by fire pending the term written in the contract. *It did not insure against peril to the property without loss during the policy term.* If the fire broke out in the insured building before the policy expired, and continued to burn thereafter until it was totally destroyed, the loss is one occurring within the insured period. It is all deemed one event, and not severable. A damage

[3]Much of the opinion is given over to whether standard time is to be applied in determining the meaning of "noon".

begun is damage done, where the culmination is the natural and unbroken sequence of the beginning. We have been cited to no case which holds that *mere imminence* of loss, or *even certainty* of loss, during the life of a contract of insurance, would justify a recovery, where there was in fact no loss or damage during the life of the contract. *No case in either marine, fire, or life insurance so holds. To do so would be to extend the term of the policy, and all liability under it, including its beginning, for a period beyond the contract for which the consideration was paid.* Doubtless it was known to be inevitable, as it proved to be, that certain blocks of the business houses in Baltimore would be destroyed by the great fire there recently, which burnt over a considerable part of the city, and raged for several days. Yet it is entirely possible that contracts of insurance expired upon the buildings last burned after the fire had begun elsewhere in their vicinity. It would be astonishing if the liability of the insurers was extended indefinitely beyond the term of their contract merely because a danger had occurred during the contract which would lead to loss thereafter . . ."

Some of the insurance in this case also covered merchandise in the buildings. The court said that the same rules applied here as to the buildings themselves, continuing [p370]:

"Where the fire had begun in the building containing the merchandise before the expiration of the policy term, and by reason of that fire it was impossible to remove or save the merchandise from loss or damage, it is to be deemed a loss

occurring in the life of the policy, whether the fire was actually communicated to the specific articles of merchandise within such time, or not."

A holding in accord with that in the *Rochester* case is found in *Globe etc Ins Co v Moffat Co* (CA 2, 1907) 154 F 13. Bark in a cannery plant was insured. The fire began 30 minutes before expiration of the policy term. The trial court instructed the jury that if the bark ignited in such a way that all would be destroyed naturally, inevitably, and directly without the intervention of any new cause, the plaintiff was entitled to full recovery even though some of the loss occurred after expiration of the policy. The judgment for plaintiff was affirmed on appeal, the opinion concerning itself primarily with other issues.

3. Fire policies, fallen building clause.

Several cases which have discussed this question of liability for loss occurring after policy termination involve the fallen building clause[4] formerly found in fire insurance policies. In some of these cases the building fell after the building was on fire, and the contention was made that the insurer was liable only for that portion of the fire damage occurring before the fall of the building. The courts have uniformly held the insurer to be liable for the entire loss.

The leading case in this field is a decision of the California Supreme Court, *Davis v Connecticut Fire*

[4]The clause provided that if the insured building or any substantial part of it should fall, except as the result of fire, all insurance under the policy on the building and its contents would immediately cease.

Ins Co (1910) 158 C 766, 112 P 549, 32 LRANS 604. In holding that the insurer was liable for all of the damage caused by a fire burning on the insured premises before the building fell, even though some of the damage occurred before and some after the fall, the court pointed to the practical impossibility of separating the fire loss that occurred before the fall of the building from that occurring afterward.

Similarly, see:

Hartford Fire Ins Co v Doll (CA 7, 1928) 23 F2 443, 56 ALR 1059;

Pruitt v Hardware etc Ins Co (CA 5, 1940) 112 F2 140;

Wiig v Girard etc Ins Co (Neb 1916) 159 NW 416, LRA 1917F 1061.

These cases cite and rely upon the *Rochester* and *Davis* cases, supra.

B. CANCELLATION CASES.

The general attitude of the California courts with respect to the validity of cancellation clauses in insurance policies is well stated in *Protex-A-Kar Co v Hartford A&I Co* (1951) 102 CA2 408, 227 P2 509. This was a declaratory judgment suit brought by an insured to fix responsibility on a liability insurer for damage occurring after the policy had been cancelled, but resulting from the use of insured's product which

had been sold before cancellation. In holding that there was no liability, the court said [227 P2, 512]:

> "Since recovery is limited to accidents occurring 'during the policy period' the insurance company cannot be held liable for accidents occurring after . . . the date of the cancellation. To construe it otherwise would give effect only to the clause declaring the policy period [that is, the original term of the policy] and would ignore the provisions of [the] cancellation clause. Since the language of the policy is clear and unambiguous its plain and unequivocal terms cannot be disregarded to make a new contract for the parties. [Cits]"

There are, of course, many cases and text statements to the effect that cancellation of an insurance policy can not affect rights which have already accrued under the policy as the result of a loss which preceded the effective date of cancellation.

We have no quarrel with this rule, and are not disputing liability for damage caused by the landslide in progress at the time of cancellation and prior to expiration of the original policy term.

There are a number of authorities which hold, and it is also well settled, that it is not necessary for the peril insured against to have actually reached and damaged the insured property in order for an attempted cancellation to be ineffective; it is sufficient that the property is exposed at the time of cancellation to an immediate and impending danger from an insured peril, to such a degree that to allow cancellation would operate as a fraud upon the insured.

One of the earliest cases on this point is

Home Ins Co v Heck (1873) 65 Illinois 111, 2 Ins Law Jnl 437.

In the *Heck* case a fire policy was issued to plaintiff insuring on cordwood. The wood was destroyed by fire and suit was brought on the policy. The defense was that before the fire reached the wood the insurer had cancelled the policy in accordance with a cancellation clause contained in it. The trial court instructed the jury that if the wood was in greater danger from fire at the time of cancellation than it was when the policy was issued, then the cancellation was ineffective. On appeal this instruction was held erroneous; the grounds for the holding and the purport of the case appear from the following portion of the opinion [2 Ins Law Jnl, 439]:

> "We think this [instruction] is laying down the law too broadly, for, by the terms of the policy, the insurer had a right to [cancel]. It cannot be claimed, however, that an insurer against fire can, when the fire is approaching the property insured, cancel the policy. This would be acting in *bad faith,* and would not be justified by the law of the contract. Insurance is a contract of indemnity, the basis of which is, or ought to be, good faith on both sides. Of what avail would it be to take a policy against fire to permit its cancellation when the fire is approaching."

The opinion goes on to say that the court properly refused an instruction that the insurer had an absolute right to cancel before the fire reached the insured property:

> "The objection to this instruction is obvious . . . It leaves out of view *threatening and immediate danger* which may environ the insured property . . . 'No court would permit an insurance company to declare a policy upon a certain building cancelled when the adjoining building was in flames.' "

In order to understand the proper scope and thrust of the *Heck* case and subsequent authorities, an examination of some of the later authorities will be helpful.

The general rule is well stated in 6 *Couch, Cyc Ins Law* 5079:

> "Although a reserved right to cancel a fire policy may be exercised in case the risk is subjected to a greater danger of fire than existed when the policy was issued, provided the right is exercised in good faith, yet, if the act of cancelation will operate as a *fraud* upon the insured, by reason of some *special emergency,* such as an approaching conflagration, or a probable and threatened peril from fire which makes the liability to loss *imminent,* the privilege reserved to terminate the policy on notice cannot be exercised, for to admit such a right would render policies valueless. And in case the notice of cancellation is given in the face of such *imminent danger,* it cannot aid the insurer that the property is actually destroyed by fire from another quarter."[5]

[5]It will be recognized that this statement is substantially merely a summarization of the *Heck* opinion, which indeed is cited in a footnote to the text.

Necessary limitations to the application of the rule prohibiting cancellation where loss is imminent are well expressed in *Treadwell v. International etc Assur Co* (Tex 1933) 60 SW2 536. Insurer issued to plaintiff's husband a combination accident and health policy naming plaintiff as beneficiary. The policy gave the insurer a right of cancellation. In August 1929 and while the policy was in force the husband became disabled by sickness, and continued disabled until October 1930 when he was instantly killed by an accidental gas explosion in his home. In November 1929 the insurer served a notice of cancellation, by reason of the disabled condition of the husband, which included a combination of very serious illnesses; however, the insurer continued to pay the sickness disability benefits called for by the policy, and did so from August 1929 until death. The suit was brought to recover for the accidental death. The insurer defended on the ground that the policy had been cancelled. Plaintiff relied upon the theory (analogous to that adopted by the trial court in the case at bar) that the imminent peril cancellation rule voided the attempted cancellation. We quote from the opinion [p537-8]:

> "Appellant [plaintiff] presents the proposition that though the policy in question reserves to the insurer the right to cancel the same upon notice, nevertheless the insurer will not be permitted to cancel the policy when such cancellation would operate as a fraud upon the rights of the insured; that the cancellation in this case under the facts did so operate and the insurer was estopped from exercising the right reserved.

In this connection appellant invokes cases from other jurisdictions which have denied the reserved right to cancel, when, at the time, a loss was imminent, and to permit such cancellation would operate as a fraud upon the assured and render the policy valueless. The question has usually arisen in connection with fire insurance policies.

It is unnecessary to review and discuss these cases. The effect of the rulings therein is well stated by Couch in 6 Cyclopedia of Insurance Law, §1434 . . .[6]

None of the authorities go so far as to deny the insurer a reserved right of cancellation simply because the risk of loss from the hazard insured against has *increased.*

We think the line of authority invoked by appellant is applicable *only when loss is imminent* and the hazard insured against is *immediately impending.*

The present facts show no imminent and impending danger to the insured of injury or death by accidental means. It is simply shown that he had become a *very hazardous risk* for accident insurance. *This condition did not deprive the insurer of its plain and unambiguous contractual right to cancel.* To hold otherwise would be to disregard the settled rule that the parties are at liberty to contract as they please with respect to cancellation and that stipulations of that character are entirely valid. [Cit]

---

[6]Here the court quotes from Couch, the quotation consisting in the main of the portion already quoted immediately above in this brief. The opinion then gives a similar quotation from 3 *Joyce on Insurance,* §1662.

> The cancellation was authorized by the contract between the parties, and it cannot be regarded as in fraud of the rights of the insured.
>
> Nor is there any merit in the contention that the cancellation was waived by appellee's action in requesting and receiving from the insured's physician reports concerning his physical condition while he was ill.
>
> Appellee was obligated to [husband] under the sick benefits of the policy—an obligation which would continue as long as his disability from sickness continued. Under such circumstances, appellee had the right to inquire and inform itself concerning [his] physical condition. . . . Requesting and obtaining such information . . . raised no issue of waiver of the right of cancellation theretofore exercised."

Subsequent cases have cited and followed the holding in Treadwell:

Friedman v Connecticut etc Ins Co (1937) 296 NYS 146;

Dullum v. Northern etc Ins Co (Ore 1942) 127 P2 749.

For an earlier decision of similar import, see *Travelers etc Assn v Dewey* (Tex 1904) 78 SW 1087.

For the sake of completeness, we refer to the following cases in the property insurance field which deal with the general rule concerning cancellation made after loss has occurred:

Stebbins v Lancashire Ins Co (1880) 60 NH 65 [fire insurance];

Lipman v Niagara Fire Ins Co (NY 1890) 24 NE 696, 8 LRA 719 [fire insurance];

Duncan v NY etc Ins Co (NY 1893) 33 NE 730, 20 LRA 386 [marine insurance];

Hasterlik v NJ etc Ins Co (1923) 229 Ill App 604 [burglary insurance];

Stephens-Adamson Mfg. Co. v Fireman's Fund Ins Co (1930) 257 Ill App 443 [fire insurance];

Zimmerman v Union etc Ins Co (Ore 1930) 291 P 495 [automobile insurance].

References to the same rule will also be found in the following annotations: 17 *AnnCas* 795, 800; 50 *LRANS* 35, 37.

The purport and limitation of the rule is well exemplified by the following quotation from the *Hasterlik* case (supra):

> "It is elementary that a policy of insurance . . . cannot be canceled after a loss has occurred *so as to affect the rights of the* [*insured*] *so far as that particular loss is concerned.*"

C. AUTHORITIES CITED BELOW.

The purport of the principal authorities cited by the District Court in its opinion [R 24-26] in support of its decision here is merely to the effect that cancellation of an insurance policy can not affect rights already accrued under the policy by reason of a loss that preceded the effective date of cancellation.[7] We refer to: 29 *AmJur* 261; 32 *CJ* 1246 (and compare, to

[7]See our discussion of the "Cancellation Cases" in the immediately preceding section of this brief.

the same effect, 45 *CJS* 81-82); and *Ins Co of North America v US* (CA 4, 1947) 159 F2 699, 701.

The cases of *Pruitt v Hardware etc Ins Co* (CA 5, 1940) 112 F2 140, and *Davis v Connecticut Fire Ins Co* (1910) 158 C 766, 112 P 549, 32 LRANS 604 cited by the trial court [R 24-25] are not cancellation cases, but are fallen building clause cases. We have discussed *Davis* and cited *Pruitt* supra, in the section dealing with the fallen building clause fire cases.

The reference to "1 L.R.A. (N.S.) 364-9" [R 25] is to the case of *Rochester etc Ins Co v Peaslee-Gaulbert Co* (Ky 1905) 1 LRANS 364, 9 AnnCas 324, which we have fully considered above. It is not a cancellation case.

The case of *Globe etc Ins Co v Moffat Co* (CA 2, 1907) 154 F 13 [cited at R 24] is considered above.

The portion of the *Heck* opinion quoted by the District Court [R 25] adds nothing to the basic holding of *Heck* (which we have discussed). It is merely to the effect that if damage to the insured property threatens from more than a single fire, the rule against cancellation would apply regardless of which fire caused the damage. As *Heck* puts it, the cancellation "would be an act done *in the face of a threatened and approaching danger*", and therefore ineffective.

D. SUMMARY OF THE EXISTING LAW.

We are now in a position to summarize the law.

1. Neither property nor liability policies cover loss occurring after expiration of the term of the policy, even though—

(a) The loss condition had commenced to operate during the policy term, and/or

(b) Actual damage had occurred to the insured property prior to expiration, and/or

(c) Further loss to the insured property from the same cause after expiration is inevitable.[8]

2. The fire cases enunciate the same rule, except that (contra to ¶b just above) if the fire has actually damaged the insured property during the policy term and continues to burn at and after expiration, the insurer is held liable for the entire loss from that fire.

The rationale of these cases is that to divide the fire loss into pre- and post-expiration damage would be a practical impossibility and would rest on mere guess.

But the courts have refused to extend the fire rule to the "inevitable" cases; that is, they hold that post-fire damage from a fire raging in adjacent premises at the time of expiration, but which did not reach the insured premises until after expiration, is not recoverable.[9]

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[8]*Export SS Corp v American Ins Co* (CA 2, 1939) 106 F2 9;
Remmer v Glens Falls Indem Co (1956) 140 CA2 84, 295 P2 19;
Protex-A-Kar Co v Hartford A&I Co (1951) 102 CA2 408, 227 P2 509;
Tulare County Power Co v Pacific Surety Co (1919) 181 C 489, 185 P 399.
See, supra, Argument, I, A.

[9]*Rochester etc Ins Co v Peaslee-Gaulbert Co* (Ky 1905) 1 LRANS 364, 9 AnnCas 324.
In *Rochester* a judgment for plaintiff was reversed because the trial court had instructed the jury that if the fire burning in adjacent premises before the "noon" of expiration of the policy made

Generally, see supra, Argument I, A.

3. The cancellation cases quite properly inject an added element (fraud, bad faith) into the determination of when there will be liability for post-termination losses.

Their thesis runs as follows. An insurance contract is one in which the utmost good faith is required on both sides. Whatever the rule may be when the policy *expires* by its own terms, it would be unconscionable to permit the insurer by exercising its reserved right of cancellation to cut off liability for damage that is inevitably about to occur to the insured person or property from an insured peril which, while it has not yet reached the subject of insurance, is so imminent that loss under the policy is threatening and immediate.

This rule is not a rule that is limited to property or fire insurance. It applies equally to all kinds of insurances. While some of the language used in some

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destruction of the insured premises inevitable, and they were destroyed after "noon" but not at all damaged before that hour.

Globe etc Ins Co v Moffat Co (CA 2, 1907) 154 F 13.

In *Globe* the fire reached the insured property before the time of expiration. In allowing recovery for all damage, pre- and post-expiration, the court emphasized that all the damage must have resulted from the pre-expiration fire *naturally, inevitably, and directly without the intervention of any new cause.*

Davis v Connecticut Fire Ins Co (1910) 158 C 766, 112 P 549, 32 LRANS 604.

Hartford Fire Ins Co v Doll (CA 7, 1928) 23 F2 443, 56 ALR 1059;

Pruitt v Hardware etc Ins Co (CA 5, 1940) 112 F2 140;

Wiig v Girard etc Ins Co (Neb 1916) 159 NW 416, LRA 1917F 1061

The rationale of the fire cases in the text of this brief is also well expressed in the *Export SS* case supra, footnote 8.

of the cases speaks in terms of the invalidity of the cancellation itself, it should be remembered that these are single peril situations where no question was before the court except that of continuing liability from the precise existing peril which commenced prior to the cancellation and which caused the damage after cancellation.

The authorities make it quite clear that neither mere increase of risk nor the existence of a "very hazardous" condition is sufficient to inhibit cancellation; the danger of loss must be "threatening and immediate", "imminent", or "immediately impending". They further demonstrate that it is not the cancellation as such that is proscribed, but rather the effectiveness of the cancellation to cut off liability for the loss thereafter occurring from the existing peril.[10]

II. THE ERRORS BELOW.

A. THE EXISTING LANDSLIDE CONDITION DID NOT PREVENT OR NULLIFY CANCELLATION OF THE POLICIES. (Specification I)

In its opinion [R 26] and conclusions of law [IV, R 33] the District Court held that the policies were

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[10] *Home Ins Co v Heck* (1873) 65 Illinois 111, 2 Ins Law Jnl 437;
Treadwell v International etc Assur Co (Tex 1933) 60 SW2 536;
Friedman v Connecticut etc Ins Co (1937) 296 NYS 146;
Dullum v Northern etc Ins Co (Ore 1942) 127 P2 749;
Hasterlik v NJ etc Ins Co (1923) 229 Ill App 604.
See, supra, Argument, I, B.

"entire", "indivisible", and "not severable".[11] From this it presumably followed that even though appellant might have cancelled as to hazards other than landslide had these been insured against separately (albeit in the same policies), such was not the case here, and so the cancellations were void *in toto*. While we do not think the question of severability of the policies in suit could be so lightly disposed of *if* it were decisive,[12] the fact is that no attempt was made by appellant to cancel part only of the policies; rather each notice of cancellation purported to cancel the respective policy as an entirety. It is therefore our conclusion that the matter of severability of the policies in suit for purposes of cancellation does not arise, and need not be further considered.[13]

The existing landslide had already caused actual damage to the insured property. It is not contended by appellant that the cancellation had any effect upon damage caused or to be caused by the existing slide condition. We concede that our liability for such damage is to be judged as though no cancellation notices had ever been sent.

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[11]In support the Court cites:
17 *CJS* 788;
Goorberg v Western Assur Co (1907) 150 C 510, 89 P 130, 10 LRANS 876, 119 AmStRep 246, 11 AnnCas 801;
US v Bethlehem Steel Corp (1942) 315 US 289, 86 LEd 855.

[12]An interesting discussion of severability as applied to insurance policies is found in 4 Appleman, Insurance Law & Practice, ch 118.

The *Goorberg* case is readily distinguishable from the situation at bar. See: *Coniglio v Connecticut Fire Ins Co* (1919) 180 C 596, 182 P 275, 5 ALR 805, annotated on the divisibility point at p808; also, for the California rule, 29 *AmJur* 201, Insurance §187.

[13]We have specified the conclusion as to severability as error [Conclusion IV, R 33; Specification I] only for the sake of completeness.

But we earnestly contend that the Court erred in holding that the existing slide and/or the damage from it completely abrogated the contractual right of cancellation, so that the cancellation notices were (as the Court put it) "null and void". No decided case and no authority supports this view. Nor is it supported by the *ratio decidendi* of any case that has come to our attention. To the contrary, all authority is opposed.[14] The *Treadwell* case is quite analogous, and quite fatal to the result reached below.

Perhaps the District Court felt that the coverage against "all physical loss" made it impossible to distinguish between physical loss caused by landslide and that which might be caused by, say, fire. But there are two fallacies here.

The minor fallacy is that only *some* of the insured property was covered for "all physical loss"; with a minor exception all the personal property insured was covered against loss from specified perils.

The major fallacy is more basic, and may be illustrated by an example. Suppose a straight fire policy, containing the usual 5-day cancellation clause. While a fire is raging in adjoining premises to the north of the insured building the insurer serves a cancellation notice. Assume that within two days the fire is extinguished without burning of or damage to the insured building. Assume that on the sixth day after service of the cancellation notice, a second fire starts on the adjoining premises to the south from causes unrelated to the first fire; the second fire promptly

[14]See, Summary of the existing law; Argument, I, D, ¶3.

spreads to and consumes the insured building. Is the insurer liable? We submit that the answer must be in the negative. While we know of no such case, every principle of law and equity would seem to support this result. True, under settled rules, the cancellation would not have been effective to defeat liability for any damage to the insured building from the first fire; but there seems to be no reason why the notice would not have served to cancel the policy in all other respects.

The District Court has fallen into error by failing to distinguish between the right to recover for a particular loss already occurred or occurring, and the right to rely on the policy for losses that may (or may not) occur *in futuro*. Here we may profitably consider the provision in most insurance policies prohibiting their assignment. It has always been held that after loss has occurred the insured's right of recovery may be freely assigned despite the policy provision *and* without in any way invalidating it.

> "It is settled that after a loss has arisen liability is fastened upon the insurer and any right of the insured as a result of the loss may be assigned with or without the consent of the insurer. [Cits]" *Vierneisel v Rhode Island Ins Co* (1946) 77 CA2 229, 175 P2 63, 65.

See also: 5 *Appleman, Insurance Law & Practice* 637, §3458.

The right of recovery for damage from a pre-existing peril (as to which the insurer may not cancel) is distinct from general rights under the policy to recover in the future for future losses that may or

may not occur from future perils. And a cancellation of the policy may cut off the latter without affecting liability for the former.

29 *AmJur* 261; Insurance § 281.

The existing landslide condition did not therefore abrogate or suspend the contractual right of cancellation. It merely meant that the right of appellees to recover for damage caused or to be caused by the landslide would remain exactly as if no notices of cancellation had been served.

B. THE COURT WAS WITHOUT POWER OR AUTHORITY TO DECREE CONTINUANCE OF THE POLICIES BEYOND THEIR STATED TERMS, WITH OR WITHOUT ADDITIONAL PREMIUM PAYMENTS. (Specification II)

1. As to damage that might result from the existing landslide peril, the Court held that appellant would be liable for all that might occur in the future—even after expiration of the terms for which the policies were written; and that the policies would remain in full force and effect until such time as the Court made a further order that the existing landslide had stabilized, and even thereafter unless then cancelled by appellant [Finding XVI, R 32; Judgment, ¶3, g, R 37-38; Judgment, ¶5, R 38].

We assume it may be asserted confidently that appellant is not worse off by having served notices of cancellation, than it would be if no such notices had been served. Let us look at the situation of continuing liability for landslide damage in that light.

Here were policies insuring against landslide, and a landslide occurs during their terms. As we have

seen, the general rule is that an insurer is only liable for damage occurring to the property insured during the policy term. The fire cases are an exception to this rule, grounded in the very nature of combustion which is a continuing and continuous process not ordinarily separable into recognizable time compartments so that to allocate part of the loss as pre-expiration loss and part as post-expiration loss would be a practical impossibility. [See, Argument, I, A and D (¶¶1, 2)]

A landslide during its temporary periods of high activity may indeed equate to the fire situation and, in a proper case upon a proper showing, justify application of the same rule, for the same reason. But no such showing was made here. On the contrary, the evidence shows a massive slide condition moving only occasionally, and now and again over a period of months causing some damage to the insured houses [R 50-54]. When these policies expire, for all that appears, the slide may have been inactive for a long time, and it would be entirely practical to ascertain the amount of damage done within the policy term.

There is, therefore, in this record no support whatever for the decree that liability for landslide damage will continue beyond the policy terms *and* thereafter for as long as the slide continues *and* thereafter until the court has decreed that the slide is over *and* thereafter until appellant serves notices of cancellation of the policies.[15]

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[15]We deliberately ignore the "alternatives" that appellant may be sooner relieved of liability (a) by paying to appellees the full

2. As to damage that might result from hazards other than landslide, the Court in effect granted to appellant an option to continue the policies in force after expiration of the terms for which they were written under a most complex and strange arrangement.

To understand this arrangement, we must examine the policies. The one that covered on the residence occupied by appellees [Ex 1] was written for a three-year term commencing 5 May 1955 and expiring 5 May 1958. The premium was stated to be $237 for the full term, if paid at inception; or, if paid in installments, a total of $244.90 payable $86.90 on inception plus $79 on 5 May 1956 and a like amount on 5 May 1957. The other policy [Ex 2] was written for a term of one year expiring 15 July 1957 for a total premium of $70.10. Its "Annual Renewal Plan Endorsement" gave to appellees the option to renew the policy annually for a maximum of four additional years on payment of an annual premium for each such additional year *calculated on the rates currently in use at the time of each renewal.*

The judgment speaks [¶3, R 36] of the "policy periods . . . which included October 1, 1956", and contrasts these with "every successive period". For such "successive periods" (without limit of time, except for duration of the landslide), appellees may continue the policies in force by payment (or tender)

face amount of its policies, or (b) by persuading appellees to "stipulate in writing to the fact that [all] duties and liabilities under said policies . . . have been fully met and performed" [R36].

of a premium for the period "in the amount established by the policies for the period which included October 1, 1956".

In the case of the one-year policy [Ex 2], it is clear that the policy period "which included October 1, 1958" was the original policy year ending 15 July 1957. But note that the policy provided specifically (a) that if the option to renew was exercised the premium payable was *not* the original premium (as the judgment provided), but rather a premium based upon the rates current at the time of renewal; and (b) that the right to renew would be lost if the policy was cancelled by either party before the renewal option was exercised. In both of these respects, then, the judgment ignored the agreement of the parties and attempted to make a completely new contract for them.

In the case of the three-year policy, the situation is more difficult. In referring to the policy period "which included October 1, 1956" was the Court referring to the original policy term ending 5 May 1958, so that at that time appellees to exercise the renewal option contained in the judgment would have to pay the full three-year premium of $237? Or did the Court have reference to the annual premium payment periods, so that appellees could renew each year on 5 May for a premium of $79? We do not know the answer to this, as the judgment is unintelligible on this point.

In any event, and under either interpretation, the Court has attempted to make a new contract for the

parties—or rather a whole series of new ones—an accomplishment which, we submit is quite beyond the judicial powers.

Absent cancellation, there is no tenable theory that occurs to us by which the Court could justify an extension of these policies for an indefinite period beyond their expressed dates of termination to cover losses from perils that had not happened, were not about to happen, and might never happen. The most that can be said is that perhaps they were somewhat more likely to happen because of the landslide condition than was the case when the policies were issued. There was, however, no evidence to this effect. But the law is clear that such a situation is not sufficient to bring into operation any post-expiration liability for damages.

And cancellation notices having been served, the case is *a fortiori*.

Appellees attempted to establish inability to obtain insurance coverage against hazards other than landslide, but the Court refused to admit such evidence as being immaterial [R 69-71]. The Court was right. See, the *Treadwell* case and other authorities on cancellation cited and discussed above [Argument, I, B].

3. With respect to loss from landslide and to loss from other hazards, the Court exceeded its powers in declaring in effect that the cancellation clause in the policies ceased to be operative because of the occurrence of the landslide and would continue to remain inoperative until further order of the Court [Judgment, ¶2, R 35-36; ¶5, R 38].

C. THE INJUNCTION AGAINST CANCELLATION WAS UNWARRANTED. (Specification III)

For the reasons already stated, the Court erred in enjoining appellant from cancelling the policies [Judgment, ¶4, R 38].

CONCLUSION

The attempted cancellations were valid, and were effective to cancel the policies in their entirety pursuant to the express right to cancel granted by the policies. It is not contended that the liability of appellant for damage from the existing landslide was or could be effected by the notices of cancellation.

The judgment should be reversed, and the cause remanded for further proceedings to ascertain and enter judgment for appellees the landslide damage incurred prior to the expiration dates of the policies.

Dated, San Francisco, California,
5 May 1958.

Respectfully submitted,
LONG & LEVIT,
BERT W. LEVIT,
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(Appendix Follows.)

Appendix

TABLE OF EXHIBITS

[Rule 18,2(f), Court of Appeals, Ninth Circuit]

All exhibits have been transmitted in original form to the Clerk of the Court of Appeals. They have not been reproduced in the printed Transcript of Record.

No. Description	Page Number, Transcript of Record Identified	Offered	Rec'd/Rej'd
Plaintiffs' (Appellees') Exhibits:			
1. Insurance Policy #HOB16557	48	48	49
2. Insurance Policy #04-500340	48	48	49
3. Cancellation Notices (4)	48	48	49
4. Letter, 1/14/57	68	68	68
Defendant's (Appellant's) Exhibits:			
A. Letter, 1/22/57	78	78	78

No. 15852

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT

v.

SPOKANE, PORTLAND AND SEATTLE RAILWAY COMPANY, A CORPORATION, APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

BRIEF FOR APPELLANT

GEORGE COCHRAN DOUB,
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No. 15852

UNITED STATES OF AMERICA, APPELLANT

v.

SPOKANE, PORTLAND AND SEATTLE RAILWAY COMPANY, A CORPORATION, APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a judgment and amended judgment in favor of the Spokane, Portland and Seattle Railway Company in eight consolidated actions brought by it to recover sums allegedly due in connection with transportation services rendered to the United States. The jurisdiction of the United States District Court for the District of Oregon was invoked under the Tucker Act, 28 U. S. C. 1346 (a) (2) (R. 7). The judgment was entered on August 26, 1957, and the amended judgment on September 17, 1957 (R. 64–65). Notice of appeal was filed on October 21, 1957 (R. 65–66). The jurisdiction of this Court is invoked under 28 U. S. C. 1291.

STATEMENT OF THE CASE

This action involves the charges of the appellee rail carrier for the transportation, between 1942 and 1945, of shipments of government-owned industrial equipment and supplies to Columbia River ports in Oregon for exportation to the Union of Soviet Socialist Republics (R. 6). These shipments were made on Government bills of lading from eastern, midwestern and western points in the United States for the account of the Procurement Division of the Treasury Department (R. 6). That Department had procured the materials, and authorized their shipment to the U. S. S. R., under the provisions of the Lend-Lease Act [1] and pursuant to requisitions received from duly authorized officials of the Soviet Government Purchasing Commission in the United States (R. 6).

Appellee as the terminal carrier and collection agent for all connecting carriers, rendered bills for this transportation (R. 6). As is required by Section 322 of the Transportation Act of 1940, *infra,* p. 13, these bills were paid "upon presentation * * * prior to audit or settlement by the General Accounting Office" (R. 6–7).

On the post-payment audit of the bills contemplated by Section 322, the Comptroller General found that the Government had been overcharged. With respect to a portion of the shipments, the audit disclosed that the Government had been entitled to land-grant deductions and that, therefore, appellee had improperly computed its charges on the basis of the

[1] Act of March 11, 1941, 55 Stat. 31, 22 U. S. C. 411, *et seq.*

full commercial rate (R. 7). As to the shipments made under 22 specified bills of lading (which are listed in Exhibit 32) the Comptroller General determined that appellee's bills should have been based on the rates published in the relevant export tariff, rather than on the higher rates published in the domestic tariff.

Appellee was requested to refund the amount of the administratively determined overpayment (R. 7). When this request was not honored, it was deducted in the payment of subsequent bills rendered by appellee, as expressly authorized by Section 322 (R. 7).

These actions were then brought under the Tucker Act to recover the deductions (R. 7). By agreement of the parties, approved by the District Court, the land-grant deductions and export rate issues were severed for the purposes of trial (R. 13).[2] Because these issues are essentially unrelated, they will be separately treated throughout this brief.

1. *Land-Grant Deductions.* The single question on this aspect of the case was stipulated to be whether the shipments involved were "military or naval property of the United States moving for military or naval and not for civil use," as that phrase was employed in Section 321 (a) of the Transportation Act of 1940, *infra,* p. 12 (R. 13). If so, the Government was entitled to land-grant deductions; if not, the carrier was entitled to charge the full commercial rate. Each party contended that the burden of proof on this question was on the other (R. 16, 19).

[2] The other issues referred to in the pretrial order were settled without submission to the court.

A substantial portion of the evidence submitted to the court on this issue was documentary in character (R. 21–26). Of particular relevance was a schedule (denominated Exhibit "A") which, as to each shipment, showed, among other things, the nature of the property transported and the statements contained in the covering requisition with respect to the intended use by the Soviet Union (R. 28–37).[3]

The schedule indicated, and the District Court so found, that the property fell into these broad categories: (1) petroleum refineries and machinery for the oil industry; (2) lunite hydraulic cement; (3) electric generators, generator sets, diesel engines and generating stations; (4) electrical power plants and equipment for hydro-electric power plants; (5) equipment for steel mills; (6) equipment for oil drilling and coal mining; (7) caustic soda; and (8) bunker coal for use in Soviet vessels (R. 28–37, 58–59).[4]

The schedule also showed that the requisitions on their face had reflected an intended military use for all of the shipped property (R. 28–37). Each requisition form contained either or both: (1) a notation, following the word "use" on the form, such as "War industry-U. S. S. R.", "Army (U. S. S. R.)", "For army and air force, U. S. S. R.", and "Used in military plants—U. S. S. R.": and (2) a more detailed statement of intended use, such as "[t]his equipment

[3] Certified copies of the requisitions themselves were also introduced in evidence (R. 21–24).

[4] A ninth category, equipment to be used at Soviet Arctic bases, is not involved on this appeal and therefore will not be discussed.

is for use in mining raw materials for the U. S. S. R. war industries" (R. 28–37).

In addition to the documentary evidence, the Government produced two witnesses on the matter of the intended use of the shipments. The first, Harry F. King, was a petroleum engineer who had been the assistant superintendent of the Sun Oil Company refinery at Marcus Hook, Pennsylvania until December 1943, when he had become Chief of the Process Section of the Petroleum Administration for War (R. 112). While in private employment, he had worked closely with Russian petroleum engineers and technicians sent to this country during the early part of World War II to study the refining processes for the manufacture of high octane gasoline used in military aircraft, and had discussed with these individuals the use to be made of the refineries which the Soviet government was endeavoring to obtain from the United States (R. 113–116). While with the Petroleum Administration for War, his duties had included the acquisition of a detailed knowledge of every aspect of the intended operation of these refineries (R. 117–119).

On the basis of his acquaintanceship with the Russian petroleum industry and its needs, and of his examination of the exhibits in evidence, King testified unequivocally that the refinery equipment here involved was intended for military use (R. 119–126). Among other things, he pointed out that the refineries were specially designed for the production of the kind of high octane aviation gasoline and aviation lubri-

cating oil which was employed by military aircraft alone;[5] and that the diesel fuel by-product of the operation of the refineries was to be employed by the army in its land operations (R. 123–126).

Turning then to the shipments of caustic soda, King discussed the prominent role that that commodity played in the refining of petroleum (R. 127). He estimated that the operation of the refineries which had been requisitioned for aviation gasoline production would require between 20 and 25 thousand tons of caustic soda annually (R. 127). He referred also to the significance of this commodity in the reclamation of used rubber (R. 127–128).

King's testimony was buttressed by that of the Government's second witness, Brigadier General Philip R. Faymonville.[6] A Regular Army officer with considerable experience in logistics, Faymonville had served several tours of duty in the Soviet Union between the two world wars (R. 70–76). From 1934 to 1939 he had been the military attache of the American Embassy in Moscow and, in the furtherance of his duties, had compiled and submitted to the War Department voluminous reports on Russian industrial production for military purposes (R. 76–78).

In September 1941, Faymonville had proceeded again to the Soviet Union as a member of the Harriman Commission, the specific purpose of which was

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[5] King noted that the refineries were adapted to the production of 100-octane gasoline and that, during the war, civilian transport planes were using 91-octane gasoline (R. 131).

[6] Because of his illness, Faymonville's testimony was received in deposition form (R. 133).

to determine the scope of Russian military needs in the common effort against the Axis powers (R. 78–80). When the Harriman mission returned to the United States the following month, he had remained behind and had served for over two years as the Chief of the American Supply Mission to the U. S. S. R. (R. 80). In that office, he had studied and continually discussed with Soviet officials, including Molotov and the Soviet Commissar for Foreign Trade, specific industrial projects essential to the prosecution of the war (R. 80–84).

With respect to the use to be made of the requisitioned petroleum refineries, Faymonville observed that the production of aviation gasoline not only was given high priority by the Soviet Government, but also "had a bearing on certain strategic plans of the United States in case we succeeded in basing American aircraft on Soviet soil for use in the Balkans or elsewhere against the German armies" (R. 88). Further, he pointed to the fact that petroleum products were not being manufactured by the Soviet Union in sufficient quantities to satisfy even the needs of its army and air force and, therefore, none were available for non-military purposes (R. 101).

Faymonville also discussed the intended use of most of the other shipments. The hydro-electric power plants and equipment, for example, were requisitioned as part of the program established to furnish electricity needed in the manufacture of munitions for the Soviet armed forces (R. 86). The mobile power stations were to be employed by the Soviet army in regions evacuated by the Germans; as Faymonville

noted, power was required to rehabilitate such essential facilities as railway switching yards, supply bases, and prisoner of war compounds (R. 86–87). And one of the important functions of the supply bases was the salvaging of tanks and other war equipment (R. 87–88).

Insofar as the steel mill equipment was concerned, Faymonville testified that it, too, was to serve in the furtherance of the manufacture of munitions, tanks, and other implements of war (R. 96–97, 102–103). Apropos of the bunker coal requisitioned for use in Soviet vessels, he made the observation that "[s]eaborne commerce for any purpose other than the carrying on of the war or the bringing in of supplies to directly support the movements of armies was an unknown thing" (R. 102).

On September 8, 1956, the District Court, per Circuit Judge James Alger Fee (sitting by special designation), filed an opinion in which it held that, despite the Government's evidence, none of the shipments involved on the appeal were entitled to land-grant deductions (R. 38–40). The ruling was based principally on this consideration (R. 39–40):

> There is very little indication in the record that any of this property ultimately was used on or near the battleground or that any of the products of any of the machinery ever were devoted to use against the common enemy. The government did not prove that any single article shipped or any single article or product of these machines actually was devoted to a war use. It might even have been surmised that

> some of the aviation gasoline manufactured by these munitions plants was used in Korea after World War II ended. But, in any event, none of the articles, machinery, or coal used in the Soviet vessels was "military or naval property of the United States."

On August 26, 1957, following the trial on the severed export rate issue (to be discussed below) Judge McCollough filed findings of fact and conclusions of law on both issues (R. 51–63). In accordance with Judge Fee's opinion, Judge McCollough found (R. 59–60):

> There is very little indication in the record that any of the property [here involved] ultimately was used in or near the battleground or that any products of any of the machinery ever were devoted to use against the common enemy. Defendant did not prove that any single article shipped or any single article or product of these machines actually was devoted to a war use.

2. *Export Rate.* It was stipulated by the parties that the sole question on this phase of the case was whether the Government had complied with the condition in Item 270 (a) of Trans-Continental Freight Bureau Export Tariff No. 29-Series that "[r]ates authorized apply only to export traffic when specific destination beyond Pacific Coast port of export is shown in bill of lading or shipping receipt issued at the time of shipment * * *" (R. 42, 46). Appellee conceded that all of the other conditions and restrictions pertaining to the application of the export tariff had been met by the Government (R. 43).

Following their arrival at the Pacific Coast port of exportation, every one of the shipments had been transported by ocean carrier to areas in the Soviet Union west of the 170th Meridian, West Longtitude, and east of the 30th Meridian, East Longitude (R. 44). In each instance, the bill of lading had listed the destination of the shipments as "U. S. S. R." (R. 47).

The Government's position was that the "U. S. S. R." notation was a showing of "specific destination" within the meaning of Item 270 (a) (R. 48). In support of this position, it demonstrated (in part through the testimony of an expert witness) the following: The tariff on its face applied to rail shipments of these specific commodities moving to the Pacific Coast ports here involved and destined for shipment therefrom by ocean common carrier to points west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude (R. 41). Since all Soviet ports to which the shipments could have been exported are within this area, the notation "U. S. S. R." enabled appellee to determine that the rates and charges provided in the export tariff were applicable (R. 149–150). Therefore, the addition of a designation of the port or ports within the Soviet Union to which the shipments were destined would not have provided appellee with any further relevant information (R. 150).

Without disclosing his reasoning, Judge McCollough ruled, however, that the "notation 'U. S. S. R.' * * * on each of [the] bills of lading was not a

showing of specific overseas destination," and that there had been a failure of compliance with a condition in the export tariff (R. 62). On the basis of this ruling, he concluded that the Government had "failed to establish" that it was entitled to the export rate (R. 63).

On August 26, 1957, judgment was entered in favor of appellee in the amount of $30,997 (which the parties had agreed appellee was entitled to on the basis of the Court's determination on the two issues) (R. 64). On September 17, 1957, an amended judgment was entered, providing for interest on the principal amount of the judgment "to the extent authorized by law" (R. 64). This appeal followed (R. 65–66).

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in holding that, in a suit to recover deductions made by the Comptroller General under the authority of Section 322 of the Transportation Act of 1940, 49 U. S. C. 66, the Government has the burden of disproving the correctness of the carrier's charges which occasioned the deductions.

2. The District Court erred in holding that the Government's entitlement to land-grant deductions was dependent upon whether the transported property, or the products thereof, "actually [were] devoted to a war use."

3. The District Court erred in not holding that the Government's entitlement to land-grant deductions was dependent upon whether, at the time of its rail

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3. The District Court erred in not holding that the Government's entitlement to land-grant deductions was dependent upon whether, at the time of its rail

movement, the transported property was destined to serve military or naval needs.

4. The District Court erred in not holding that the shipments here involved were "military or naval property of the United States moving for military or naval and not for civil use" within the meaning of Section 321 (a) of the Transportation Act of 1940, 49 U. S. C. (1940 Ed.) 65 (a).

5. The District Court erred in not holding that, in the circumstances of the case, the notation on the bills of lading that the shipments were destined for exportation to the "U. S. S. R." constituted compliance with the condition in the export tariff that the "specific destination beyond Pacific Coast port of export" be shown.

6. The District Court erred in holding that the United States had "failed to establish" that it was entitled to the export rate.

7. The District Court erred in entering judgment for appellee.

STATUTES INVOLVED

1. During the period relevant to this litigation, Section 321 (a) of the Transportation Act of September 18, 1940, 54 Stat. 954, 49 U. S. C. (1940 Ed.) 65 (a), provided in relevant part that the full applicable commercial rates were to be paid for transportation by any common carrier of property for the United States with the exception of "military or naval property of the United States moving for military or naval and not for civil use * * *." This exception was removed by the Act of December 12,

1945, 59 Stat. 605, effective October 1, 1946. The latter statute provides, however, that "any travel or transportation specifically contracted for prior to [the] effective date shall be paid for at the rate * * * in effect at the time of entering into such contract of carriage or shipment."

2. Section 322 of the Transportation Act of September 18, 1940, 54 Stat. 955, 49 U. S. C. 66, provides as follows:

> Payment for transportation of the United States mail and of persons or property for or on behalf of the United States by any common carrier subject to the Interstate Commerce Act, as amended, or the Civil Aeronautics Act of 1938, shall be made upon presentation of bills therefor, prior to audit or settlement by the General Accounting Office, but the right is reserved to the United States Government to deduct the amount of any overpayment to any such carrier from any amount subsequently found to be due such carrier.

ARGUMENT

Introduction and summary

In the court below, appellee insisted that the burden was on the Government to prove that the deductions made by the Comptroller General were justified; *i. e.,* to disprove the correctness of appellee's charges (R. 16, 47–48). Placing total reliance on this theory, appellee introduced no evidence whatsoever on the question as to whether the shipments were "military or naval property of the United States moving for

military or naval and not for civil use" and thus entitled to land-grant deductions.

For its part, the Government urged that the burden was on appellee to prove that its bills for the transportation of the lend-lease property were correct, and that, therefore, the deductions were improper (R. 19, 49). Unlike appellee, however, the Government nevertheless went forward with evidence on both the land-grant and export rate issues.[7] With respect to the former, it showed that at the time of rail movement (and at all subsequent times) the property was intended for either (1) use by the Soviet armed forces in the conduct of World War II or (2) use in the production or transportation of electricity, petroleum, munitions and other implements of war for those armed forces and essential to their operations. With reference to the export rate issue, it was shown that the notation "U. S. S. R." on the bills of lading provided appellee with all the information that the "specific destination" condition in the export tariff was designed to afford the carrier and that, as a conse-

[7] The Government recognized that, even though it did not have the burden of proof, it might be expected to come forth with all the factual information in its possession with regard to the nature of the shipments and the purpose for which they were moving. Because of this recognition, it placed before the court below both the relevant requisitions of the Soviet Government Purchasing Commission and the testimony of two witnesses who were particularly qualified on the matter of the use to be made of the property by that government. It, of course, cannot be said that, by thus going forward with its own proof despite the complete lack of any evidence on appellee's part, the Government abandoned its consistent position that the ultimate burden of persuasion was on appellee.

quence, the notation represented full compliance with that condition.

Accepting appellee's argument that the burden of proof was on the Government, the court below held that it had not been met. On the land-grant issue, the court took the test to be whether "any of this property ultimately was used in or near the battleground or * * * any of the products of any of the machinery ever were devoted to use against the common enemy" (R. 39). Applying this test, the court ruled in appellee's favor on the ground that "[t]he Government did not prove that any single article shipped or any single article or product of these machines actually was devoted to a war use" (R. 39). And, on the export rate issue, the court—without discussing the Government's evidence or stating what it deemed to be the governing criteria—concluded that the United States had "failed to establish" that it was entitled to the export rate (R. 63).

1. In Point I below, we show that the recent decision of the Supreme Court in *United States* v. *New York, New Haven and Hartford R. Co.*, 355 U. S. 253—taken alone—requires a reversal on both issues. In the *New Haven* case, the Supreme Court was called upon to decide the precise burden of proof question that underlies this case; indeed, that was the only question that was before the Court. Rejecting the contention which appellee makes here, the Supreme Court expressly held that, in a suit to recover amounts deducted under Section 322 of the Transportation Act, the carrier must prove the correctness of the charges challenged by the Comptroller General on the post-

audit; in other words, must prove that the deductions made on the basis of that audit were not warranted.

We do not think appellee will be heard to assert that it sustained the burden of proof which, by virtue of the *New Haven* decision, rested upon it. In any event, since appellee introduced no evidence—in the mistaken belief that the burden was on the Government—any such contention necessarily would fail.

2. In Point II we show that, apart from the matter of the improper assessment of the burden of proof, the determination of the court below on the land-grant issue was erroneous. It is settled under decisions of the Supreme Court, this Court and other courts that the critical inquiry is not, as the court below thought, whether the shipped property, or the products thereof, *actually* reached a battleground or were otherwise directly employed against the enemy. Rather, the relevant criterion has always been whether, at the time that the rail shipment took place, the property was *intended* for a military or naval use. And, measuring the evidence adduced below by the Government against the standard adopted in those cases for ascertaining what constitutes such a use, there can be no doubt that the transportation of the property here involved was subject to land-grant deductions.

3. In Point III, we demonstrate that there is no greater justification for the holding below that the notation "U. S. S. R." on the bills of lading did not constitute a showing of a "specific destination" within the meaning of Item 270 (a) of the export tariff. Since the tariff nowhere defines "specific destination," the meaning of that phrase necessarily must be deter-

mined by reference to the purposes which, according to the Interstate Commerce Commission, the condition was intended to serve. As the evidence reflects, the "U. S. S. R." notation wholly fulfilled those purposes. In the final analysis, appellee asks this Court to hold that the Government is to be denied the export rate on export traffic moving to areas specified in the relevant export tariff solely because the bill of lading was not encumbered with superfluous data.

I. The holding below that the Government had the burden of disproving the correctness of appellee's charges is contrary to *United States* v. *New York, New Haven and Hartford R. Co.*, 355 U. S. 253

1. The question as to where the burden of proof lies in Tucker Act suits to recover deductions made under Section 322 of the Transportation Act, *supra*, p. 13, has now been definitively resolved by the Supreme Court. *United States* v. *New York, New Haven and Hartford R. Co.*, 355 U. S. 253, decided December 16, 1957. The situation in the *New Haven* case was procedurally identical to that here. During 1944, the rail carrier had transported shipments of naval property. Pursuant to Section 322, its bills for this transportation had been paid upon presentation, prior to audit. Subsequently, as in this case, the Comptroller General had determined that the carrier had overcharged the Government and, when its demand for refund was not honored, had deducted the amount of the overcharge in the payment of a bill rendered by the carrier for 1950 transportation services. The carrier then brought suit under the

Tucker Act, ostensibly on the 1950 bill, to recover the deducted amount. The District Court and the Court of Appeals both held (as did the court below) that the burden was on the Government to prove that the deductions were correct (*i. e.,* that the 1944 bills had been improperly computed). On this holding, both courts concluded that the carrier was entitled to judgment even though it had not offered any evidence on the controlling issue of fact.[8]

In an 8 to 1 decision, delivered by Mr. Justice Brennan, the Supreme Court reversed. Stating that the single question before it was whether "the carrier has the burden of proving the correctness of the 1944 bills, or the Government the burden of proving that it was overcharged," the Court observed at the outset [355 U. S. at 255]:

> Before enactment of § 322, the Government protected itself against transportation overcharges by not paying transportation bills until the responsible government officers, and, in doubtful cases, the General Accounting Office, first audited the bills and found that the charges were correct. When charges were questioned the carrier was required to justify them. If administrative settlement was not reached and the carrier sued the United States to recover the amount of the bill, no one questions that it was the carrier's duty to sustain the burden of proving the correctness of the charges. *Southern Pacific Co.* v. *United States,* 272 U. S. 445, 448.

[8] Unlike this case, the Government also had not introduced any evidence.

> Section 322, however, required the payment of such bills "upon presentation * * * prior to audit or settlement by the General Accounting Office * * *" The audit procedures remained substantially the same as those in effect prior to the statute but the former means of protecting against overcharges—by not paying the bills until their correctness was proved—has, by force of the statute, been replaced by the method of collecting them from subsequent bills, under the right reserved by the section to the Government "to deduct the amount of any overpayment to any such carrier from any amount subsequently found to be due such carrier." We recently said in *United States* v. *Western Pacific R. Co.*, 352 U. S. 59, 74:
>
> "* * * This right [to deduct overpayment from subsequent bills of the carrier] was thought to be a necessary measure to protect the Government, since carriers' bills must be paid on presentation and before audit."

Again at page 75:

> "The fact that the Government paid the carrier's bills as rendered is without significance in light of § 322 of the Transportation Act, *supra,* requiring payment 'upon presentation' of such bills and postponing final settlement until audit."

Turning then to the legislative history of Section 322, the Court determined [355 U. S. at 257] that it fully supported "this interpretation of [the] section." It noted that [355 U. S. at 260]:

> The conclusion is inescapable from this history that the Congress was desirous of aiding the railroads to secure prompt payment of their

charges, but it is also clear that the Congress, and the railroads, contemplated that the Government's protection against overcharges available under the pre-audit practice should not be diminished. *The burden of the carriers to establish the correctness of their charges was to continue unabridged.* The carriers were to be paid immediately upon submission of their bills but the carriers were in return promptly to refund overcharges when such charges were administratively determined. The carrier would then have "to recollect" the sum refunded by justifying its bills to the agency or by proving its claim in the courts. The footing upon which each of the parties stood when controversies over charges developed was not to be changed. *The right of the United States to deduct overpayments from subsequent bills was the carriers' own proposal for securing the Government against the burden of having to prove the overpayment in proceedings for reimbursement.* [Emphasis supplied.]

The Court concluded [355 U. S. at 261–262]:

* * * the Government's statutory right of setoff was designed to be the substantial equivalent of its previous right to withhold payment altogether until the carrier established the correctness of its charges. Thus the issue of overcharges, after the enactment of § 322, arises in a different way, but the differing procedures by which the issue is presented should not control the placement of the burden of proof. In effect the situation is that the railroad is suing to recover amounts which the Government initially paid conditionally, and then recaptured,

> under the § 322 procedure. *We therefore hold that the burden of the carrier to establish the lawfulness of its charges is the same under § 322 as it was under the superseded practice.* [Emphasis supplied.]

Less than a month later, the Fifth Circuit held that the *New Haven* case required the reversal of a judgment in favor of a carrier which, like the one before this Court, had been based on a determination that the burden was on the Government to disprove the correctness of the carrier's charges. *United States* v. *Missouri Pacific R. Co.,* 250 F. 2d 805, decided January 14, 1958. And because, in its view, the carrier had not established that the bills in issue had been properly computed (and that the Comptroller General's deduction was in error), the Fifth Circuit remanded with instructions to enter judgment for the Government.[9]

2. It follows that the court below erred in placing the burden on the Government with respect to the correctness of appellee's charges. As the *New Haven* case holds, appellee's obligation was no different than it would have been had the pre-1940 practice of auditing transportation bills prior to payment re-

[9] The factual issue in the *Missouri Pacific* case was whether a shipment of Government property weighed 9290 pounds (as claimed by the Comptroller General) or 35,300 pounds (as claimed by the carrier). In support of its claim, the carrier had put into evidence a correction way bill reflecting the higher figure. The Government had relied exclusively on the bill of lading notation of the lower weight. The Court of Appeals apparently regarded neither document as more persuasive than the other.

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mained in effect. Under that practice, as the Supreme Court pointed out, appellee would not have obtained payment of its bills computed on the basis of the commercial or domestic rates unless and until it proved a clear right to the application of those rates.

That appellee, in common with the carrier in the *Missouri Pacific* case, *supra,* did not meet its burden is equally plain. On the land-grant issue, the only evidence as to the character of the shipments was introduced by the Government—which, despite appellee's burden of persuasion, presented the court with all of the information at its disposal. As heretofore seen, that evidence reflected (1) that the Soviet Government had requisitioned the property for use by its armed forces and by those industries engaged in the manufacture of materials essential to the combatant operations of these armed forces; and (2) that the United States in honoring the requisitions, intended that the property be given that use. Appellee made no effort to rebut this showing and the record contains nothing to suggest that the property was destined to serve any other purpose.

True enough, the District Court thought that the actual use made of the property by the Soviet Union, and not the use intended at the time of the rail shipment, was the only relevant consideration (and thus, in effect, held that the Government's evidence was immaterial). While, for reasons to be developed below, we think this ruling to be erroneous, the fact remains that the record is equally devoid of anything which would support a finding that, following their

arrival at their ultimate destination, the shipments had been diverted to a "civil use" (as that term is used in Section 321 (a) of the Transportation Act) and thereby had lost their prior status as military property moving for a military use. And no such finding was made.

Appellee's lack of proof extended to the export rate issue as well. Appellee sat back and made no effort to refute the Government's evidentiary showing that the notation of destination on the bill of lading was sufficiently specific to afford appellee with all the information which the "specific destination" condition of the export tariff was designed to give it.

II. The undisputed evidence clearly establishes that the shipments were entitled to land-grant rates

We submit that the foregoing considerations, taken alone, require a reversal of the District Court's determination on the land-grant issue. Even if, however, the court below had been right in its view that the burden of proof was on the Government, appellee still would not have been entitled to recover. As we now show, the court's construction of Section 321 (a) of the Transportation Act is at variance with both the terms of the Section and its uniform prior judicial interpretation. Measured against the latter interpretation, the Government's evidence established that the shipments were entitled to land-grant deductions.

A. The critical inquiry under Section 321 (a) of the Transportation Act is whether, at the time of rail movement, the shipments were military or naval property intended for a military or naval use

As the Tenth Circuit observed in *Sonken-Galamba Corp.* v. *Union Pacific R. Co.,* 145 F. 2d 808, 812

(C. A. 10), it is a settled principle of transportation law that "the nature and character of each shipment *at the time tendered* determines its status for rate purposes [rather than] the use which may be subsequently made of the material. * * * Tariff rates cannot be applied retrospectively, neither can the character of the material be made to depend upon an independent investigation concerning its use after it has passed from the consignee of the shipper." [Emphasis supplied.]

In Section 321 (a) Congress carried this precise thought over into the area of land-grant deductions. Notwithstanding the contrary view of the court below (R. 39), the Section does not speak in terms of "military or naval property ultimately * * * used on or near a battleground" or employed in the manufacture of materials actually "devoted to use against the common enemy." The critical phrase in the statute is instead "military or naval property *moving for* military and naval and not for civil use." [Emphasis supplied.]

If, when delivered to the rail carrier, there is a *bona fide* intent that the shipment be put to military or naval use, it is clearly "moving for [such a] use." This is so irrespective of whether developments subsequent to the completion of the rail movement may interfere with the carrying out of that *bona fide* intent. By way of illustration, a rail shipment of munitions to a port of exportation for use in a foreign theater of operation might be destroyed by enemy action while in ocean transit, or for some similar reason might not

actually be employed in combat. We think it hardly could be seriously contended that, because of this consideration, the property while in rail transit, would be moving for a civil use.

These considerations were given express recognition in *Northern Pacific Ry. Co.* v. *United States,* 101 F. Supp. 29 (D. Minn.). There, the Government shipped quartermaster and ordnance material to salvage and redistribution centers. Following arrival at these centers, the goods were inspected and a certain portion reconsigned for naval and military use. The remainder was sold as army or navy surplus.

The carrier contended that the items which were disposed of as surplus had to be regarded as shipped for civilian use, and therefore as being not entitled to land-grant rates. Rejecting this contention, the court pointed out initially that the purpose of these shipments was to permit the fulfillment of the military responsibility of determining whether the property would be given a military or war surplus use; that it was fair to assume that the dominant purpose of the shipments was to salvage as much of the property as possible for military use; and that, insofar as was known at the time of the rail movement, all of it might have been allocated for such use. Thus, the court reasoned, "[n]one of the goods lost their military status until they were separated from military use after the shipment had ended and then allocated for civilian use."

Holding that "[t]he character and status of the shipment of military stores by common carrier should be determined at the time of the shipment," the court

referred to the above quoted language in the *Sonken-Galamba* case. It then stated [101 F. Supp. at 31]:

> The language [in Sonken-Galamba] was used with reference to the interpretation of an ordinary tariff rate and not to a situation under the land-grant statutes, but it is not inappropriate herein. In other words, there should be a definiteness and finality in the character of these goods at the time that they were transported, so far as the applicable rate is concerned, and that should not be dependent upon some future contingency. [The carrier's] theory of tracing the items in these shipments which were finally discarded and sold for civilian use and determining the commercial rate thereon illustrates and emphasizes the necessity of applying the rule above enunciated.
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> * * * * *
>
> The "use" contemplated at the time and during shipment of these goods was not a civilian use. That was not the dominant purpose of the transportation. The primary purpose of the transportation [was the] examination of these goods by military and naval officials so that they might determine whether a part or all should be rehabilitated and reconsigned for military purposes. Such an object persuasively establishes that the shipments were made for military use as that term is used in the statutes. It is not necessary that all of the goods were in fact put to military use.

All of the other reported decisions are fully consistent with this analysis. In *Northern Pacific Ry. Co.* v. *United States,* 330 U. S. 248, 255, for example, the Supreme Court spoke in terms of the shipments hav-

ing been "*destined* to serve military or naval needs". [Emphasis supplied.] And in *United States* v. *Powell,* 330 U. S. 238, 247, decided the same day, the Court stated:

> It is sufficient here to say that the fertilizer was being transported for a "civil" use within the meaning of § 321 (a), since it was *destined for use* by civilian agencies in agricultural projects and not for use by the armed services to satisfy any of their needs or wants or by any civilian agency which acted as their adjunct or otherwise service them in any of their activities. [Emphasis supplied.]

In *Southern Pacific Co.* v. *Defense Supplies Corp.,* 64 F. Supp. 605 (N. D. Cal.), affirmed by this Court, *sub nom., Southern Pacific Co.* v. *Reconstruction Finance Corporation,* 161 F. 2d 56, the court observed (64 Supp. at 607):

> The words "military" and "naval" as used in the Act are descriptive adjectives. In context they may refer to property of the War or Navy Departments but they also properly and logically are descriptive, irrespective of ownership, or the nature of the property itself, with respect not merely to its tangible form and characteristics but as well * * * to the nature of its *contemplated* use. [Emphasis supplied.]

And in *Southern Pacific Co.* v. *United States,* 67 F. Supp. 966, 968, involving Lend-Lease shipments to China, the Court of Claims determined:

> That the shipments were not for "civil" use is quite certain and the plaintiff does not maintain that they were for "civil" use. The

> argument goes that they were for *disposition* to a foreign government, as distinguished from *use*. We are not impressed with this argument. The United States was deeply concerned as to their use, and it is manifest that the reason they were for delivery to the Republic of China was that they were to be *used* by the Chinese Army, that is, intended for military and not for civil use.

See also *Pennsylvania R. Co.* v. *United States,* 125 F. Supp. 233, 237 (C. Cls.) ("lend-lease requisitions show[ed] the intended use of the [property] to be for military purposes").

In no case that we have discovered was it intimated, let alone held, that the criterion is anything other than the contemplated use of the property. Indeed, as will be seen below, in *Southern Pacific Co.* v. *Reconstruction Finance Corporation, supra,* this Court determined that motor benzol, procured for stock piling purposes and intended for ultimate use in the production of aviation gasoline and synthetic rubber for the armed forces, was military property moving for military use even though a significant portion was actually employed in the manufacture of products used by civilians.

B. The shipments were military or naval property and were intended for a military or naval use

The question before the court below was thus whether, at the time of the rail movement, the shipments were "military or naval property of the United States" intended for a "military or naval and not for civil use." We submit that the record leaves no doubt

that the answer is in the affirmative. Accordingly, despite the error of the court below both in formulating the issue before it and in assessing the burden of proof, the Government is entitled to judgment without the conduct of further proceedings. Cf. *United States* v. *Missouri Pacific R. Co., supra,* p. 21.

1. In *Northern Pacific Ry. Co.* v. *United States,* 330 U. S. 248, the Supreme Court was called upon to determine whether the following shipments came within the exception to Section 321 (a): (1) copper cable for use in the installation of equipment for mine defense on a cargo vessel which was convertible into a military or naval auxiliary; (2) lumber to be employed in the construction of a government-owned munitions plant being built by civilian contractors under the supervision of the Army; (3) lumber destined for eventual use (following drying and milling) by a civilian contractor in the manufacture of floating bridges to be used by marines in training and combat; (4) bowling alley equipment to be installed at a naval air base in Alaska, for recreational use first by the civilian construction crew at the base and then by navy personnel; and (5) liquid paving asphalt to be used by a civilian contractor in constructing runways in Alaska for a Civil Aeronautics Authority program which had been approved as necessary for national defense.

Deciding that every one of these shipments was entitled to the land-grant rate, the Court first cast aside [330 U. S. at 252–254] the carrier's suggestion

(1) that shipments to civil agencies cannot be "military or naval property"[10] and (2) that the Section 321 (a) exception is confined to property for ultimate use directly by the armed forces. It then turned [330 U. S. at 254] to the contention that "none of the articles shipped * * * was military or naval, since they were not furnished to the armed forces for their use [but] were supplied * * * for manufacture and construction which are civilian pursuits." In the course of determining that this contention was equally lacking in merit, the Court gave this controlling definition to the statutory terms (330 U. S. 254–255):

> In general the use to which the property is to be put is the controlling test of its military or naval character. Pencils as well as rifles may be military property. Indeed, the nature of modern war, its multifarious aspects, the requirements of the men and women who constitute the armed forces and their adjuncts, give military or naval property such a broad sweep as to include almost any type of property. More than articles actually used by military or naval personnel in combat are included. *Military or naval use includes all property consumed by the armed forces or by their adjuncts, all property which they use to further their projects, all property which serves their many*

[10] "We see no merit in that suggestion. Section 321 (a) makes no reference to specific agencies of departments of government. The fact that the War or Navy Department does the procurement might, of course, carry special weight or be decisive in close cases. But it is well known that procurement of military supplies or war material is often handled by agencies other than the War and Navy Departments." [330 U. S. at 253.]

needs or wants in training or preparation for war, in combat, in maintaining them at home or abroad, in their occupation after victory is won. It is the relation of the shipment to the military or naval effort that is controlling under § 321 (a). The property in question may have to be reconditioned, repaired, processed or treated in some other way before it serves their needs. But that does not detract from its status as military or naval property. *Southern Pacific Co.* v. *Defense Supplies Corp.,* 64 F. Supp. 605. Within the meaning of § 321 (a) an intermediate manufacturing phase cannot be said to have an essential "civil" aspect, when the products or articles involved are destined to serve military or naval needs. It is the dominant purpose for which the manufacturing or processing activity is carried on that is controlling.[11] [Emphasis supplied.]

The Court went on [330 U. S. at 257]:

> [The carrier] also contends that § 321 (a) is a remedial enactment which should be liberally construed so as to permit no exception which is not required. Cf. *Piedmont & N. Ry. Co.* v. *Interstate Commerce Commission,* 286 U. S. 299, 311–312. But it is a familiar rule that where there is any doubt as to the meaning of a statute which "operates as a grant of public property to an individual, or the relinquishment of a public interest," the doubt should be resolved in favor of the Government and against the private claimant. *Slidell* v. *Grand-*

[11] Applying this test to the shipments before it, the Court concluded [330 U. S. at 255]:

"[T]here can be no doubt that the five types of property

jean, 111 U. S. 412, 437. See *Southern Ry. Co.* v. *United States,* 322 U. S. 72, 76. That rule has been applied in construing the reduced rate conditions of the land-grant legislation. *Southern Pacific Co.* v. *United States,* 307 U. S. 393, 401; *Southern Ry. Co.* v. *United States, supra.* That principle is applicable here where the Congress, by writing into § 321 (a) an exception, retained for the United States an economic privilege of great value.

In *Southern Pacific Co.* v. *Reconstruction Finance Corporation, supra,* the shipments of motor benzol had been transported by the carrier for the account of

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involved in the present litigation were "military or naval" property of the United States "moving for military or naval and not for civil use" within the meaning of § 321 (a). The lumber for the pontoons, the asphalt for the airfield, the lumber for the ammunition plant were used in Army or Navy projects directly related to combat preparation or to actual combat. Copper cable for the cargo vessel, though farther removed from that category, was well within the definition of "military or naval" property. It, too was a defensive weapon. Beyond that it was purchased by the Navy Department and consigned to one of its officers. It was supplied pursuant to Navy specifications; and the ship on which it was installed was being prepared for possible ultimate use by the Navy. The bowling alleys were also well within the statutory classification. The needs of the armed forces plainly include recreational facilities. The morale and physical condition of combat forces are as important to the successful prosecution of a war as their equipment. The fact that the bowling alleys were planned for initial use of civilian workers makes no difference. *It is the nature of the work being done, not the status of the person handling the materials, that is decisive. Supplies to maintain civilians repairing Army or Navy planes is a case in point. The dominant purpose of the project in this case was the same whether civilians or military or Navy personnel did the actual work.*" [Emphasis supplied.]

the Defense Supplies Corporation, which had purchased the commodity pursuant to a War Production Board recommendation that 50 million gallons be stockpiled for later allocation "for defense purposes." Each bill of lading was marked "For Military Use". 13.4 percent of the benzol was eventually used in the manufacture of rubber products sold for civilian uses pursuant to allocations made by the War Production Board. The remainder was employed in the manufacture of rubber products and 100 octane aviation gasoline sold to the Army and Navy.

In urging in this Court that the transportation of the benzol was not subject to the land-grant rate, the carrier stressed that the commodity was only a material from which, when used in conjunction with other materials, a finished war product was made. Additionally, it argued that the finished product became "military or naval property" only when subsequently acquired by the Army or Navy.

On the authority of *Northern Pacific,* this Court ruled that the land-grant rate applied. It pointed to the Supreme Court's determination that the asphalt shipment was "military or naval property" despite the fact that it was consigned to a civilian agency. Reference was also made to the observation in *Northern Pacific* that "[w]ithin the meaning of § 321 (a) an intermediate manufacturing phase cannot be said to have an essential 'civil' aspect when the products or articles involved are destined to serve military or naval needs" and that "[i]t is the dominant purpose for which the manufacturing or processing activity

is carried on that is controlling." Finally, this Court took note of the Supreme Court's admonition that Section 321 (a) is to be construed against the carrier.

Northern Pacific was also relied upon by the Court of Claims in *Chicago and Northwestern Ry. Co.* v. *United States,* 74 F. Supp. 943. That case involved coal, sulphur and lime which had been shipped to ordnance plants. The coal had been intended to be used in the production of heat, steam and hot water; the sulphur in the manufacture of smokeless powder; and the lime in treating and softening water necessary to the operations of a facility engaged in manufacturing small arms. Concluding [74 F. Supp. at 944] that "these shipments clearly fall within the purview of the decision and the test laid down in [*Northern Pacific*]," the Court of Claims observed that it could "see no substantial distinction between materials shipped for the construction of a plant for military or naval use and materials for the operation of such a plant."

In *Southern Pacific Co.* v. *United States,* 67 F. Supp. 966, the same court determined that it was of no moment that the property (motor vehicles and parts) was intended for lend-lease use by an ally, rather than for use by the United States.[12] Further, the court held that the designation "Army use" on the

[12] This determination is supported by *United States* v. *Powell*, 330 U. S. 238, involving lend-lease shipments of fertilizer to Great Britain. While the Supreme Court held that land-grant rates did not apply, that holding did not rest upon the fact that the fertilizer was to be used by an ally. See 330 U. S. at 243.

requisition furnished by the ally sufficiently established that the property was for military and not for civil use [67 F. Supp. at 968]:

> The requisitions, certified copies of which are in evidence, are on a form designated "Form 1." This form has a space calling upon the applicant to state whether the articles desired are for Army, Navy, Air, or Commercial use. The applicant designated them as for "Army use," and the requisitions were honored as submitted.
>
> The inevitable conclusion must be that the articles in transit were for military not for civil use.

See also, *Pennsylvania R. Co.* v. *United States,* 125 F. Supp. 233 (C. Cls.).

2. Like in the *Southern Pacific* case in the Court of Claims, virtually all the requisition forms relating to the property involved in this case expressly stated that the items were to be used by the Soviet armed forces or in a war industry. A substantial number of them elaborated upon the nature of that use.

We submit that these notations constituted at least *prima facie* evidence of an intended military use of the property and that, having offered no evidence to the contrary, appellee cannot be heard now to assert that the shipments were moving for some other use. *Southern Pacific Co.* v. *United States, supra,* 67 F. Supp. at 968. But were appellee right in its assertion (R. 16) that the notations of use were merely "competent evidence," its position would not be improved. The uncontradicted testimony of the Government's witnesses wholly substantiated the accuracy of the no-

tations. Further, that testimony dispels all possible doubt that the property "was destined to serve military or naval needs" within the meaning of the Supreme Court's *Northern Pacific* decision and was not, as appellee insisted below (R. 16), intended merely to strengthen and rehabilitate the over-all economy of the Soviet Union.[13]

On the basis of (1) his extensive knowledge of the Soviet petroleum industry and its needs and (2) an examination of the specifications which were introduced into evidence, King testified that the refinery equipment was particularly adapted for, and was intended for use in, the production of that type of high octane aviation gasoline and aviation lubricating oil which the Soviet Union was utilizing in military aircraft alone (R. 123–126, 131). King further testified that the diesel fuel by-product of the refining process was especially suited for use by the Soviet land army, which had become "somewhat Dieselized" (R. 124). On the same subject Faymonville, whose knowledge of the needs of the Soviet armed forces was probably as extensive as that of any other American official, testified both to the high priority that was given

[13] Appellee so argued in an endeavor to bring this case within *United States* v. *Powell*, 330 U. S. 238. In *Powell*, the Supreme Court held that the property was being transported for a "civil" use because, unlike the shipments in *Northern Pacific*, it was destined for use by civilian agencies in agricultural projects and not for use by the armed forces or by any civilian agency which serviced them in any of their activities. See p. 27, *supra*. As the discussion in the text of this brief shows, the property here involved was to be used either by the armed forces directly or by industries servicing their needs.

by the Soviet government to the refining of aviation gasoline and to the dire shortage of those petroleum products required in the prosecution of the war (R. 88, 101). He also discussed the bearing that aviation gasoline production had upon the Allied plan of undertaking to base American aircraft on Russian territory for attacks upon the common enemy (R. 88).

Thus, in the words of the Supreme Court, the refineries had an unmistakable "relation * * * to the military effort" of the Soviet Union. It was property which was to be used to "further [the] projects" of the Soviet "armed forces [and] adjuncts" and which was destined to serve "their many needs or wants in training or preparation for war, in combat * * *." In no essential respect can the use for which the refineries were transported be distinguished from the intended use of any of the articles involved in the *Northern Pacific* case. If anything, equipment which is shipped for, and necessary in, the production of fuel for military aircraft has a much more "dominant [military] purpose" than, to cite one example, bowling alleys for recreational use. And, the parallel between the refineries and the motor benzol involved in *Southern Pacific Co.* v. *Reconstruction Finance Corporation, supra,* is even more striking. The motor benzol, after all, had been shipped for precisely the same ultimate use—the production of aviation gasoline.

Caustic soda also was used extensively in petroleum refining, as well as in the reclamation of used rubber (R. 127). In the circumstances, it too can be readily analogized to the motor benzol (which played a part in rubber production in addition to petroleum refin-

ing). It can also be compared to the sulphur and lime shipped in the *Chicago & N. W. Ry. Co.* case, *supra,* for use in the manufacture of gun powder and small arms.

That the bunker coal was moving for an intended military use is seen from the fact that all Soviet seaborne commerce was employed in the direct support of the movement of armies (R. 102). It is noteworthy in this connection that, in *Northern Pacific,* the Supreme Court gave this answer to the carrier's assertion that the land-grant rate is confined to only property for ultimate direct use by the armed forces [330 U. S. at 253–254]:

> Under that view materials shipped for the construction of vessels for the Maritime Commission and used to service troops at home or abroad would not be "military or naval" property. We likewise reject that argument. Civilian agencies may service the armed forces or act as adjuncts to them. The Maritime Commission is a good example. *An army and navy on foreign shores or in foreign waters cannot live and fight without a supply fleet in their support. The agency, whether civil or military, which performs that function is serving the armed forces. The property which it employs in that service is military or naval property, serving a military or naval function.* [Emphasis supplied.]

Cf. *National Carloading Corp.* v. *United States,* 221 F. 2d 81 (C. A. D. C.).

The hydroelectric power plants, the mobile power stations, and the steel mill equipment similarly were requisitioned in the furtherance of projects being

carried out to satisfy immediate military requirements. The hydroelectric facilities were to provide electricity for the operation of munitions plants (R. 86). The mobile stations were to supply power to facilities maintained by the advancing Soviet army (R. 86–88). The steel mill equipment was to produce munitions, tanks and other items which had a dominant, if not sole, military purpose (R. 96–97, 102–103).

III. The Government complied with the condition in the export tariff that specific destination beyond Pacific Coast port of export be shown

The remaining question in the case is whether, as to the shipments made under the twenty-two bills of lading listed in Exhibit 32, the Government was entitled to the rates published in Trans-Continental Freight Bureau West-Bound Export Tariff No. 29-Series. This tariff, which was in effect at all relevant times, established export commodity rates from designated points within the United States to Pacific Coast ports on traffic destined for shipment by ocean common carrier to points west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude (R. 41).

The applicability of these rates was subject to compliance with numerous conditions and restrictions set forth in Items 235 and 270 (a) of the tariff (R. 41–42). The shipments could not leave the possession of the rail carrier until delivery to the ocean common carrier at the Pacific Coast port. They could not be diverted to another destination while in possession of the rail carrier. They could not be held at

the port of export or en route thereto on request of the shipper, owner or other interested party. The specific destination beyond the Pacific Coast port of export had to be shown in the bills of lading or the shipping receipts issued at the time of shipment.

It was stipulated by appellee that all of the shipments on the twenty-two bills of lading were in fact exported by ocean carrier to the Soviet Union and to a point or points therein west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude (R. 44). It was further stipulated that there had been compliance with the first three of the aforementioned conditions and restrictions (R. 43).

The sole justification advanced by appellee for charging the higher domestic rate was that there had been a failure of compliance with the remaining condition, that the specific destination beyond the Pacific Coast port of export be shown (R. 43). In this connection, it took the position that the "U. S. S. R." notation which had been made on each bill of lading did not constitute a showing of "specific destination" for the purposes of Item 270 (a); that the Government lost the benefit of the export rate because the bill of lading did not show the port in the U. S. S. R. to which the shipments were in fact transported by ocean carrier (R. 47).

We submit that, in the context of this case, this construction of the "specific destination" condition is indefensible and that, since the traffic moved to points within the designated area and all conditions

were met, the Government was entitled to the export rate.

1. The term "specific destination" as used in Item 270 (a) is not defined anywhere in the tariff. Its meaning therefore must be ascertained by an inquiry into the purpose which the condition was intended to serve. Each condition precedent to the application of the export tariff necessarily was inserted in the tariff for a good and substantial reason—and not merely to harass shippers or to place technical pitfalls in the path of their entitlement to the export rate on export traffic which was bound for, and actually went to, the area specified therein. Unless construed in terms of that reason, the condition would clearly violate Section 1 (6) of the Interstate Commerce Act, 49 U. S. C. 1 (6). That Section imposes a mandatory duty on rail carriers "to establish, observe and enforce just and reasonable classifications of property for transportation, with reference to which rates, tariffs, regulations, or practices are or may be made or prescribed * * *." It further provides that "every unjust and unreasonable classification, regulation, and practice is prohibited and declared to be unlawful." [14]

There is another basis for reading undefined tariff conditions in light of their purpose. Since a tariff is a representation by the carrier that it will "furnish certain services under certain conditions for a

[14] If one of two or more alternative interpretations of a tariff will result in a violation of the Interstate Commerce Act, it must be avoided. *Great Northern Ry. Co.* v. *Delmar Co.*, 283 U. S. 686, 691.

certain price," its terms must be given "that meaning which the words used might reasonably carry to the shippers to whom they are addressed." *Union Wire Rope Corp.* v. *Atchison, T. & S. F. Ry. Co.,* 66 F. 2d 965, 966–967 (C. A. 8), certiorari denied, 290 U. S. 686. Consequently, "the definition [of a term in a tariff schedule] in any particular instance must depend upon the environment of the particular use * * *." *Id.* at 970. Otherwise stated, "[t]ariffs must be fairly and reasonably construed in the light of their general design and purpose, to best effect their object." *Boone* v. *United States,* 109 F. 2d 560, 562 (C. A. 6). Cf. *Carpenter* v. *Texas & New Orleans R. Co.,* 89 F. 2d 274, 277 (C. A. 5); *Chesapeake & Ohio Ry. Co.* v. *United States,* 1 F. Supp. 350 (E. D. Va.).[15]

2. As the District of Columbia Circuit observed in *United States* v. *Interstate Commerce Commission,* 198 F. 2d 958, 967, the conditions and restrictions in the export tariff are policing measures "designed to prevent shippers of domestic freight from obtaining the lower export rate by misrepresentation and chicanery." In the *War Materials Reparation Cases,* 294 I. C. C. 5, 43–44, the Interstate Commerce Commis-

[15] A corollary principle, equally well settled, requires that all reasonable doubt as to the meaning of a tariff provision be resolved in favor of the shipper. *United States* v. *Gulf Refining Co.*, 268 U. S. 542; *Southern Pacific Co.* v. *Lothrop*, 15 F. 2d 486 (C. A. 9); *Union Wire Rope Corporation* v. *Atchison T. & S. F. Ry. Co., supra; International Milling Co.* v. *Lowden*, 91 F. 2d 270 (C. A. 8); *United States* v. *Strickland Transportation Co.*, 200 F. 2d 234 (C. A. 5); *Willingham* v. *Seligman*, 179 F. 2d 257 (C. A. 5); *American Ry. Express Co.* v. *Price Bros.*, 54 F. 2d 67 (C. A. 5); *Raymond City Coal & Transportation Corp.* v. *New York Central Ry. Co.*, 103 F. 2d 56 (C. A. 6).

sion expanded upon the purposes to be served by these conditions and restrictions, with particular reference to that condition in Item 270 (a) which is in issue here:

> * * * The principal reason for requiring in item 270 that the oversea destination be shown by the shipper was that * * * the railroad required knowledge of the destination to identify the trans-continental traffic as in fact tendered for movement to such destination. The requirement that the destination be shown in billing at the time of shipment also helped to prevent the application of export rates to shipments that would move freely on the higher domestic rates. *There was no occasion to apply the lower export rates on a shipment forwarded to a Pacific port without knowing its ultimate disposition and only in anticipation of a sale, after arrival at the port, at some indefinite point in the Pacific area.* * * *
>
> * * * * * * * * * *
>
> * * * The conditions of the item [270] were also considered essential to minimize or prevent delay and congestion, to keep track of the through movement, *to enable the assessment of the correct export rate, which varied according to particular areas of destination in the Pacific,* to facilitate compliance with United States customs and other Government regulations, including those of foreign countries, and to expedite handling through the port. [Emphasis supplied.]

The "U. S. S. R." notation clearly fulfilled all of these purposes. In the first place, since it informed the carrier that the shipments were moving to a des-

tination within the Soviet Union, it "prevented the application of export rates to shipments that would move freely on the higher domestic rates" to the extent that it would have if "Vladivostok" or some other port had been added.

More importantly, the undisputed evidence below shows that the notation enabled the carrier to assess the correct export rate. Although, as the Commission noted, the rate "varied according to particular areas of destination in the Pacific," the undisputable fact is that all Soviet ports to which the shipments could have been exported are west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude. Consequently, as testified to by the Government's witness (R. 149–150), *all traffic moving for exportation to the Soviet Union from the Pacific Coast* was entitled to the rates published in Export Tariff No. 29–Series. That tariff, of course, prescribed the same rate on a given commodity irrespective of where in the area west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude, the shipment may have been destined.

Similarly, the "U. S. S. R." notation was plainly sufficient to serve the other purposes alluded to by the Commission, such as the expeditious handling of the shipment through the port of export and the facilitation of compliance with governmental regulations. In this regard as well, appellee has not pointed to a single way in which its knowledge of the Soviet port would have been of assistance to it.

In short, as appellee tacitly concedes, the "U. S. S. R." notation provided all of the information which was contemplated by the specific destination condition in Item 270 (a) and which was required by appellee both for the computation of the appropriate charges and for all other relevant purposes. To have added the port in the Soviet Union to which the shipments were destined would have been simply to encumber the bill of lading with data which, from appellee's standpoint, was totally irrelevant.

This all assumes, of course, that the inclusion of the surplusage would have been consistent with existing security regulations. While we do not stress the point, the listing on the face of a semi-public document (such as a bill of lading) of the port of destination of a cargo of war material might well have placed the safe arrival of the cargo in jeopardy. Granting that this consideration would not have excused a failure to supply meaningful information to the carrier,[16] it assuredly has a bearing upon the construction which, in the circumstances, revealed by the record, is to be given to Item 270 (a).

3. The court below did not indicate the reasons which led it to the conclusion that, notwithstanding the foregoing, the notation "U. S. S. R." was not a showing of specific destination for the purposes of

[16] We do not suggest, for example, that the Government would have complied with the condition had the bill of lading not indicated that the shipments were destined for the Soviet Union. As heretofore seen, appellee needed that information in order to determine whether the rates specified in the export tariff were applicable.

Item 270 (a). It may be, however, that it was influenced by *Union Pacific R. Co.* v. *United States,* 132 F. Supp. 230 (C. Cls.). Appellee placed almost entire reliance on that case in urging that the Government was to be denied the export rate because the bill of lading did not reflect the port in the Soviet Union to which the shipments were destined (R. 137).

Union Pacific involved, *inter alia,* a group of shipments to Pacific Coast ports for exportation to the Soviet Union. A Section 22 Quotation offered by the railroads and accepted by the Government provided that, if there was non-compliance with any of the conditions of the export tariff, the Government would nevertheless receive the export rate but would not be given land-grant deductions.[17] If, however, there was compliance with the conditions, the Section 22 Quotation would become inoperative and the Government would be entitled to land-grant deductions in addition to the export rate.

In the Court of Claims, the carrier contended that the provisions of the Section 22 Quotation applied because there had been non-compliance with a number of the conditions of the export tariff. Respecting the condition here involved, the carrier made the same argument that appellee makes, *i. e.,* that the notation "U. S. S. R." was not a showing of specific destination.

In lengthy findings of fact, the Court of Claims accepted the carrier's position as to all of the alleged

[17] Section 22 of the Interstate Commerce Act, 49 U. S. C. 22, authorizes rail carriers to transport Government property at reduced rates.

instances of non-compliance with tariff conditions. Insofar as can be ascertained from those findings, however, the court gave little consideration to the "specific destination" matter. Of course, it had not been called upon to give *any* consideration to it (since the determination on the other conditions rendered academic the question of the sufficiency of the "U. S. S. R." notation).

In any event, this much is clear: the court made no endeavor to justify its finding (132 F. Supp. 248) that the "U. S. S. R." notation "did not show the specific overseas destination".[18] Assuming that the court was aware that the carrier did not need to know the port of destination within the Soviet Union, it did not offer an explanation as to why that port nevertheless had to be shown on the shipping documents.

In theses circumstances, we fail to see how appellee can seriously suggest that *Union Pacific* be taken as controlling. Surely, in view of the complete absence of any discussion of the question either in its findings or in its opinion, the Court of Claims' bare conclusion is of scant precedential value. And, for the reasons which have already been developed, we think it clear that that conclusion is wrong—at least as applied to this case. We stress again that no principle of tariff law of which we are aware permits, let alone dictates, the use of Item 270 (a) to deny the benefit of the export rates on these shipments solely because

[18] In its opinion, the court stated merely that [132 F. Supp. at 232]: "As set out in our findings, the defendant did not comply with a number of conditions in connection with Items 235, 270, 285 and 290 of [the tariff]."

the Government did not furnish the carrier with information of a wholly superfluous nature. Put another way, the "U. S. S. R." notation having been specific enough to apprise appellee of all that it needed to know, it must be taken to have constituted a showing of "specific destination." Any other construction of Item 270 (a) would render the condition patently unjust and unreasonable, and thus unlawful. See p. 41, *supra*.[19]

CONCLUSION

For the reasons stated, it is respectfully submitted that the judgment below should be reversed.

GEORGE COCHRAN DOUB,
Assistant Attorney General,
C. E. LUCKEY,
United States Attorney,
ALAN S. ROSENTHAL,
Attorney, Department of Justice.

APRIL 1958.

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[19] (1) Appellee also relied below (R. 45–47, 138–140) on (1) a proposed change in the language of Item 270 (a) which would have added "or country" after "specific destination"; and (2) a 1944 change which deleted the word "specific". Insofar as the former is concerned, since the change was cancelled before it became effective, it is difficult to understand how it could serve as an aid in construing Item 270 (a) as actually written. Further, it would appear to have been intended to clarify the Item, rather than to alter its import.

The deletion of the word "specific" took place after the movement of the shipments in this case. In any event, we do not think that this change lends support to appellee's contention that "specific destination" always meant "port."

APPENDIX

Statement as to exhibits pursuant to subdivision 2 (f) of Rule 18 of this Court:

Exhibit No.	*Identified*	*Offered and received*
1–29 (inclusive)	21–26	110
30	26	(1)
31–33 (inclusive)	49	139
34–36 (inclusive)	49	140
A	6	6

[1] Exhibit 30 is the Faymonville deposition (R. 67–108). Pursuant to direction of the court, it was tendered for introduction into evidence after the trial proceedings had concluded. (R. 110, 134.)

U. S. GOVERNMENT PRINTING OFFICE: 1950

No. 15852

United States
COURT OF APPEALS
for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

v.

SPOKANE, PORTLAND AND SEATTLE RAILWAY COMPANY, a corporation,
Appellee.

APPELLEE'S BRIEF

Appeal from the United States District Court for the District of Oregon.

HONORABLE CLAUDE MCCOLLOCH, Judge.

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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 5–58

SUBJECT INDEX

TABLE OF CASES

TABLE OF CASES (Cont.)

MISCELLANEOUS

No. 15852

United States
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APPELLEE'S BRIEF

Appeal from the United States District Court for the District of Oregon.

HONORABLE CLAUDE MCCOLLOCH, Judge.

STATEMENT OF THE CASE

Defendant appeals from a judgment and amended judgment entered by the district court in favor of the plaintiff railway company for the stipulated amount of $30,997.00 (R. 64-65).

In the first pretrial order, thirteen separate actions brought by the plaintiff under the Tucker Act (28

U.S.C.A. § 1346(a)(2) were consolidated for trial (R. 12). Prior to the entry of judgment, five of the actions were severed and disposed of by separate judgments or orders of dismissal (R. 40-41, 53).

The stipulations of fact contained in the two pretrial orders (R. 3-10, 28-37, 41-46) eliminated the need of testimony as to great many basic facts. The first pretrial order presented to the court the one segregated issue as to whether certain rail shipments made by the United States during the years 1942-1945 under 47 separate requisitions submitted by officials of the Soviet Government Purchasing Commission (R. 28-37) embraced "military or naval property of the United States moving for military or naval and not for civil use," as those words are used in Section 321(a) of the Transportation Act of 1940 (R. 13).

With respect to that issue, the following facts were stipulated:

(1) By reason of releases filed with the Secretary of the Interior, pursuant to Section 321(b) of the Transportation Act of 1940, the United States was bound to pay to plaintiff and its connecting carriers the full applicable commercial rates for rail transportation of property of the United States, except that the United States was entitled to land-grant rates with respect to "military or naval property of the United States moving for military or naval and not for civil use" (R. 5).

(2) During the years 1942 to 1945 plaintiff and connecting interstate carriers transported on government bills of lading certain property of the United States from

Eastern, Midwestern and Western points to Columbia River ports in Oregon and there made delivery to the consignees. All of the shipments were made for the account of the Procurement Division, United States Treasury Department, which under authority delegated to it by the President had procured the property for the United States and authorized its shipment to Soviet Russia under the provisions of the Lend-Lease Act (22 U.S.C.A. §§ 411-419). The property was procured as a result of requisitions received from authorized officials of the Soviet Government Purchasing Commission in the United States in accordance with procedures established under the Lend-Lease Act (R. 6).

(3) The particular shipments involved in this appeal fall into eight categories: (1) lunite hydraulic cement; (2) petroleum refineries and machinery for the oil industry; (3) electric generators, generator sets, diesel engines and generating stations; (4) electrical power plants and equipment for hydroelectric power plants; (5) equipment for steel mills; (6) oil drilling and coal mining tools and equipment; (7) caustic soda; and (8) bunker coal. Attached to the pretrial order was a schedule enumerating the particular shipments and disclosing information which appeared on the face of Lend-Lease requisitions submitted by officials of the Soviet Government Purchasing Commission. The most frequent notation on these requisitions as to use was "War Industry—U.S.S.R." or "Military Production" (R. 28-37).

(4) The bills which plaintiff rendered to defendant

for the transportation of this property were paid in full. Thereafter, upon post-payment audit of the bills, the General Accounting Office contended that the United States was entitled to land-grant deductions on each of these shipments on the ground that they consisted of "military or naval property of the United States moving for military or naval and not for civil use," and that deductions would be made from amounts otherwise due to plaintiff unless the alleged overpayments were refunded within sixty days. When plaintiff failed to refund these amounts, the United States thereafter deducted the amounts corresponding to the alleged overpayments from payments for subsequent transportation services (R. 7). Plaintiff's cause of action in each instance was to recover these deductions from current freight bills (R.7-8, Ex. 29).

These consolidated cases came on for trial upon the pretrial order and the one segregated issue framed therein (R. 109). At the trial, all the exhibits (Nos. 1-29) were marked and admitted in evidence as the joint exhibits of both parties. These exhibits included certified copies of all the requisitions (Exs. 1-8). There were also introduced various documents taken from the government's files, as well as copies of many of the President's Reports to Congress on Lend-Lease operations during the war years (Exs. 16-26) and a pamphlet issued by the Department of State entitled "Soviet Supply Protocols" (Ex. 27).

At the trial the plaintiff rested upon this record of stipulated facts and documentary evidence. Defendant

called one witness, Mr. Harry F. King (R. 111-133), and later took the deposition in San Francisco of Brigadier General Philip R. Faymonville (R. 70-107, Ex. 30), who was unable to testify at the trial because of illness (R. 133).

After trial both parties submitted briefs to Judge Fee who filed his opinion on September 9, 1955, holding that except for property falling within the category "Equipment for Soviet Arctic Bases," none of the property involved was military or naval property of the United States moving for military or naval and not for civil use. As will be hereinafter shown, Judge Fee accepted plaintiff's thesis that this issue was controlled by the decision of the United States Supreme Court in *United States v. Powell,* 330 U.S. 238, 67 S. Ct. 742, 91 L. Ed. 868.

Following Judge Fee's decision, this consolidated case was transferred to the calendar of Chief Judge McColloch for further proceedings. The parties then entered into further pretrial stipulations with respect to transportation rates and charges based upon Judge Fee's opinion, and without prejudice to defendant's right to challenge this decision on appeal. All the remaining questions of fact and law were disposed of by the parties in these further pretrial conferences, except the one issue as to whether or not defendant was entitled to through export rates on shipments covered by 22 separate bills of lading (R. 52-53). The right to the export rate turned on whether or not the defendant had complied with Item 270(a) of Trans-Continental Freight

Bureau West-Bound Export Tariff No. 29-Series, which provided in pertinent part: "Rates authorized apply only to export traffic when specific destination beyond Pacific Coast port of export is shown in the bill of lading or shipping receipt issued at time of shipment."

After the severance of five of the actions from the consolidated proceeding, the court approved a supplemental pretrial order (R. 40-50) which segregated for separate trial the one question as to whether a notation "U.S.S.R." on a representative bill of lading was a "specific destination beyond Pacific Coast port of export" within the meaning of Item 270(a) of Transcontinental Freight Bureau West-Bound Export Tariff No. 29-Series (R. 46).

With respect to this issue, the specific provisions of the tariff were stipulated; it was agreed that one government bill of lading (DA-TPS-281224) was representative of all the bills of lading involved. It was further stated in the supplemental pretrial order that all of the shipments were in fact exported in the years 1942-1945, inclusive, by ocean carrier to the U.S.S.R. and to an area in Russia west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude (R. 44).

This issue then came on before Judge McColloch for trial upon the supplemental pretrial order. At the trial the applicable tariff provisions, an agreed computation of charges and the representative bill of lading were offered and received into evidence as joint exhibits (R. 139). After some argument on the tariff question, de-

fendant called one witness, Mr. Thomas McNeill, a transportation specialist in the General Accounting Office. A motion to strike his testimony as to the computation of rates was made "on the ground that it is not material or relevant to the specific issue in this case, which is the question of law as to the construction of this tariff." The court ruled that the testimony might stand subject to the objection (R. 150).

Briefs were filed by both parties following the trial, and the court thereafter ruled that the United States was not entitled to through export rates on the shipments covered by the 22 separate bills of lading. The court found that defendant had failed to comply with the provisions of Item 270(a) of the export tariff because the specific destination or destinations beyond the Pacific Coast port of export were not shown in any of the bills of lading issued at the time of shipment, and that the ". . . notation 'U.S.S.R.' under 'Marks' on each of said bills of lading was not a showing of specific overseas destination" (R. 62). While the court did not prepare a formal opinion, the record indicates that Judge McColloch followed the unanimous decision of the Court of Claims on the identical point in *Union Pacific Railroad Company v. United States,* 132 F. Supp. 230 (R. 137-139).

Judge McColloch further reviewed the entire proceedings. He concurred in Judge Fee's previous decision, and adopted the court's opinion of September 9, 1955. Therefore, Judge McColloch entered findings of fact and conclusions of law on both of the land-grant and export rate questions (R. 51-63).

On August 26, 1957, the court entered judgment in favor of the plaintiff in the amount of $30,997.00 (the amount being stipulated on the basis of the court's rulings). On September 17, 1957, an amended judgment was entered providing for interest thereon "to the extent authorized by law" (R. 64-65). The defendant's notice of appeal was filed October 21, 1957 (R. 65-66).

STATUTE INVOLVED

Section 321(a) of the Transportation Act of September 18, 1940, 54 Stat. 954, 49 U.S.C. (1940 Ed.) 65(a), provided as follows:

> "Sec. 321. (a) Notwithstanding any other provision of law, but subject to the provisions of sections 1 (7) and 22 of the Interstate Commerce Act, as amended, the full applicable commercial rates, fares, or charges shall be paid for transportation by any common carrier subject to such Act of any persons or property for the United States, or on its behalf, except that the foregoing provision shall not apply to the transportation of military or naval property of the United States moving for military or naval and not for civil use or to the transportation of members of the military or naval forces of the United States (or of property of such members) when such members are traveling on official duty; and the rate determined by the Interstate Commerce Commission as reasonable therefor shall be paid for the transportation by railroad of the United States mail: *Provided, however,* That any carrier by railroad and the United States may enter into contracts for the transportation of the United States mail for less than such rate: *Provided further,* That section 3709, Revised Statutes (U.S.C., 1934 edition, title 41, sec. 5), shall not hereafter be construed as requiring advertising for bids in connection with

> the procurement of transportation services when the services required can be procured from any common carrier lawfully operating in the territory where such services are to be performed."

The statutory exception was repealed by the Act of December 12, 1945, 59 Stat. 605, effective October 1, 1946, which provided that transportation specifically contracted for prior to the effective date should be paid for at the rate in effect at the time of entering into such contract of carriage or shipment.

INTRODUCTION

Defendant's brief is replete with statements that at the trial plaintiff introduced "no evidence whatsoever" on the first segregated issue as to whether the shipments were "military or naval property of the United States moving for military or naval and not for civil use," and thus entitled to land-grant deductions (App. Br. pp. 13, 16, 18, 22). On this assumption the argument is advanced that the very recent case of *United States v. New York, New Haven & Hartford R. Co.*, 355 U.S. 253, 78 S. Ct. 212, 2 L. Ed. 2d 247, "requires a reversal" because that case holds that any carrier has the "burden of proof" as to the correctness of the charges challenged by the Comptroller General on the post-audit (App. Br. p. 15).

The *New Haven* case actually holds, as we shall later demonstrate, that the burden of proof requirement is not changed by the procedure of Section 322 of the Transportation Act of 1940 (49 U.S.C.A. § 66), which provides for payment by the government of transporta-

tion charges upon the presentation of the bills. The immediate payment is subject to review by the General Accounting Office, and to the right to repayment of overcharges, usually exercised through deductions from amounts found due on subsequent transactions.

In the *New Haven* case, the court held that since the railroad had the burden of proving the correctness of the charges billed, that burden had not shifted to the government because of the Section 322 procedure. In the case at bar, the facts require the opposite assumption; in an action by the carrier to recover the amount of the charges as billed, the government would have had the burden of proving the facts entitling it to the statutory exception of land-grant deductions.

Since plaintiff did introduce abundant factual evidence to support its claims, defendant's statements to the contrary notwithstanding, and since all of the basic facts in question were undisputed, the burden of proof question perhaps becomes unimportant. The facts came into the record through the agreed statements of fact in the pretrial orders, and the multitude of documentary evidence introduced as joint exhibits of both parties. In fact, the only part of this record which contains any evidence apart from stipulated facts is the testimony of defendant's witnesses Mr. King, General Faymonville and Mr. McNeill, and it is plaintiff's position that this testimony, even when accepted in its entirety, adds nothing of importance to the stipulated facts in determining the correctness of the judgment below.

In other words, the two issues were resolved by the

court below as questions of law: (1) the correctness of the land-grant rate determination turns upon the proper interpretation of Section 321(a) of the Transportation Act of 1940 (54 Stat. 954); (2) the decision on the export rate issue presents only a question of the proper construction of a railroad tariff, " . . . a question of law, not differing in character from those presented when the construction of any other document is in dispute" (*W. P. Brown & Sons Lumber Co. v. Louisville & Nashville R. Co.,* 299 U.S. 393, 397, 57 S. Ct. 265, 81 L. Ed. 301; *Union Pacific Railroad Co. v. Ore-Ida Potato Products,* 252 F.(2d) 505, 507 (CA9)). As stated by Judge Fee in *Walling v. California Conserving Co.,* 74 F. Supp. 182, 183 (N.D. Cal.), aff'd 166 F.(2d) 905 (CA9), cert. den. 335 U.S. 845, 69 S. Ct. 69, 93 L. Ed. 395: " . . . the doctrine of burden of proof applies not to the interpretation of the statute, but only to the weight of the evidence of fact." The same observation is equally applicable to the construction of a written tariff. Thus, irrespective of any contentions made by the parties in this case, the doctrine of burden of proof was not decisive, or perhaps of primary importance, in the proceedings below.

SUMMARY OF ARGUMENT

1. The industrial equipment and supplies moving to Russia during World War II pursuant to Lend-Lease Act procedures were not shown to be "military or naval property of the United States moving for military or naval and not for civil use," within the meaning of

Section 321(a) of the Transportation Act of 1940 and the Lend-Lease Act, as construed by the United States Supreme Court in *United States v. Powell,* 330 U.S. 238, 67 S. Ct. 742, 91 L. Ed. 868.

2. The recent case of *United States v. New York, New Haven & Hartford R. Co.,* 355 U.S. 253, 78 S. Ct. 212, 2 L. Ed. (2d) 247, is not relevant to the case at bar. It holds that Section 322 of the Transportation Act (49 U.S.C.A. § 66) does not change the burden of proof otherwise governing the parties. In that case, the carrier, irrespective of Section 322, would have had to plead and prove its right to a higher charge based upon the fact that the shorter railroad cars ordered by the government were unavailable; and the facts as to the availability of cars were peculiarly within the knowledge of the carrier. In the case at bar, defendant claimed the benefit of a special statutory exemption entitling it to a reduced rate. Under these circumstances, the burden of proof was upon defendant to establish its right to the lower charges, the facts on this issue being within the peculiar knowledge of the defendant.

3. The defendant was not entitled to the export rate by reason of noncompliance with Item 270(a) of Transcontinental Freight Bureau West-Bound Export Tariff No. 29-Series, since the representative bill of lading showed "destination" only as "Portland, Oregon," and the notation "U.S.S.R." under "Marks" was not a showing of "specific destination beyond Pacific Coast port of export."

ARGUMENT

I

The decision in United States v. Powell, 330 U.S. 238, 67 S. Ct. 742, 91 L. Ed. 868, compels the conclusion that the shipments of industrial equipment and supplies to Soviet Russia under the Lend-Lease Act were not entitled to land-grant rates.

Defendant attacks Judge Fee's opinion in the court below (R. 38-40) on the ground that the court's critical inquiry was whether the shipped property, or the products thereof, actually reached a battleground, or were otherwise directly employed against the enemy rather than the use intended at the time of the rail shipment (App. Br. pp. 16, 22). This is an unwarranted distortion of the true basis of the court's opinion. Judge Fee's determination rested upon quite a different basis. In fact, he rejected the contentions of defendant and its witnesses that because the economy of Soviet Russia during World War II was "utterly geared for war" no shipment made to the Soviet Union pursuant to the Lend-Lease Act ". . . could possibly have been devoted to any other purpose" (R. 39).

The government's theory on this point is borne out by General Faymonville's testimony on direct examination (R. 90):

> "Q. General, will you state whether in your discussions with the Russian representatives, with respect to the power program, any statements were made that any of the power equipment was intended to supply power for production other than equipment to be used by the Soviet armed forces?

A. Yes, the matter did come up for discussion. It came up for discussion because I had been instructed to raise the point in instructions from Washington. I did raise it and in all cases received assurances that production for other than military purposes, purposes other than the direct prosecution of the war—there simply were no such cases—civilian production was virtually non-existent. By civilian production, I mean production for civilian use.

In the first place, there were almost no civilians as we know the word 'civilian.' All the inhabitants of the Soviet Union were in some measure drawn into the fighting forces or the immediately supporting agencies of the fighting forces."

On cross-examination, the witness stated (R. 103-104):

"Q. It is your testimony, isn't it, General, that the entire Russian economy was completely geared for war, is that right, during the hostilities?

A. Yes, sir, it is my observation that after the invasion by Hitler and the reconstitution of Russian economy on a war basis that that was true.

Q. Well, was the Government of Russia, was it run by the military or was it run by civilian agencies?

A. By the government of Russia. I assume an answer would properly specify the executive branch of the Soviet Government. The executive branch of the Soviet Government continued its control over all the agencies of that Government in the form of commissariats equivalent in general to an American executive department of the Government.

Q. Yes?

A. To answer your question, they did continue to control the operations of the Russian Government.

Q. Well, wouldn't you say that these commissariats like the Commissariat of Heavy Industry

and the Commissariat of Railways and this Sovflot, were they not civilian agencies as we think of the term civilian?

A. Well, we have to be precise about definitions here. My answer to your question is no, they were not civilian agencies as we think of civilian agencies, because no such things as our concept of civilian agencies existed in the Soviet Union. They were governmental agencies not independent of the Government and not free to conduct operations independent of Government schedules, Government plans, Government economic rules."

However, Judge Fee held that the clear-cut distinction which Congress made between "military" and "civil" use must control, irrespective of the fact that so-called "civilian" activities were nonexistent in the Soviet Union during World War II. The nub of Judge Fee's decision is in this one sentence of his opinion (R. 39): "The clear dichotomy between military or naval use and civilian use, which Congress drew in the statute, must be obliterated before such a result can be attained." The result which the court was referring to was the classification of industrial equipment and supplies as "military or naval property of the United States moving for military or naval use," merely because there was no such concept as civilian use in the Soviet Union during the years 1941-1945.

Thus, in rejecting the concept that because all the shipments involved herein were "defense articles" as defined in the Lend-Lease Act of 1941 (22 U.S.C.A. §§ 411-419), they were entitled to land-grant rates, Judge Fee followed the controlling decision in *United States v. Powell,* 60 F. Supp. 433 (D.C. Va.), aff'd 152 F.(2d)

228 (CA4), aff'd 330 U.S. 238, 67 S. Ct. 742, 91 L. Ed. 868.

Defendant's brief relies primarily upon *Northern Pacific Ry. Co. v. United States,* 330 U.S. 248, 67 S. Ct. 747, 91 L. Ed. 876, and decisions following it (App. Br. pp. 29-34). These cases did not involve shipments under the Lend-Lease Act. While the shipments in the *Northern Pacific* case did not consist of articles which would be classified as military, they were intended for use in military operations. An example is bowling equipment for recreational use by the armed forces.

The *Powell* decision is the one authoritative United States Supreme Court case interpreting and relating the Lend-Lease Act to Section 321(a) of the Transportation Act of 1940. That case involved World War II shipments by the United States of phosphate rock and superphosphate. This material was exported to Great Britain under Lend-Lease and consigned to the British Ministry of War Transport for use as farm fertilizer under Britain's wartime program for intensified production of food. The Supreme Court, per Mr. Justice Douglas, found that this fertilizer would make possible increased food production, thus sustaining the war production program and making possible the continued manufacture of munitions, arms and other war supplies necessary to maintain the armed forces. Nevertheless, the court determined that the shipments were not entitled to land-grant rates because the standard written into Section 321(a) did not reflect the necessities of national defense or the demands which total war makes on an

economy. Instead, Congress used more conventional language—"military or naval" use, as contrasted with "civil use," thus emphasizing " . . . a distinction which would be largely obliterated if the requirements of national defense, accentuated by a total war being waged in other parts of the world, were read into it" (330 U.S. at p. 245).

In that case, the government contended that the Lend-Lease Act was enacted as a military measure, that its primary purpose was to secure the military defense of the United States, and that all Lend-Lease shipments, whether to be used indirectly or directly in the war effort, were "defenes articles" and were military property moving for a military use (330 U.S. 238). In the opinion of the district court, the following contention of the government was quoted from its brief (60 F. Supp. at p. 438):

> " 'In an integrated war economy, the supply of raw materials, the exploitation of the industrial plant, and the utilization of the land for food production are directly related to war. With modern science and changed methods of war transforming many substances once considered unimportant for a belligerent's purposes into strategic military material, the general language "military property" cannot be limited to the precise items which would have been embraced within it centuries ago.' "

The phosphate rock shipped was to be used as fertilizer in the production of food; and it was urged that the phosphate shipments had the direct function of keeping Britain actively in the fight against Germany, and that although the use was initially through civilian farmers, that use was decidedly a military and not a civil use.

cause Russia at that time made no distinction between production for military purposes and production to meet the needs of its people. This is made plain by General Faymonville's testimony (R. 98):

> "Q. What happened to the third 'five-year plan' upon the invasion of Russia by the Germans?
>
> A. The Soviet Government immediately through all media of communication announced that the exact provisions of the third five-year plan were being suspended, that the country was entering as of that minute into a war economy, and that all the efforts of the inhabitants and all the resources of the industry of the country were to be devoted to the production of those items which would assist immediately—immediately assist in the war effort."

In discussing the use of petroleum products in Russia during World War II, General Faymonville stated (R. 101):

> "A. Petroleum products were not produced in sufficient volume even to satisfy the needs of the Red Army and the Red Air Force so that none were ever available for other purposes. This is not to say, however, that the Government neglected or starved auxiliary activities such, for instance, as tractors on collective farms or other petroleum requirements which were in essential support of the war effort."

General Faymonville's reservation states the obvious. No war economy could neglect or starve "auxiliary activities" essential to maintain the health and vigor of the country's citizens. "War Industry" in the requisitions included power plants (R. 31, 33, 34). However, these plants, although operated by a government without a "civil" economy, could not limit their operations

to the production of power required for munitions, arms or other supplies for the armed forces.

When these Lend-Lease shipments were made, whether of power plants, petroleum refining facilities, electric generators, diesel engines, equipment for steel mills, oil drilling and coal mining machinery, caustic soda or bunker coal, it would have been impossible to make the distinction required by Section 321(a).

It does not help defendant's case to say that in the Soviet Union there was no "civil" use. There was in fact no civil *economy,* but there was necessarily civil *use.* This civil use, though government-directed and designed to promote the war effort in every way, was essentially the same as the use of Lend-Lease materials in Great Britain which were involved in the *Powell* case. Great Britain had a civil economy, but there is no doubt that with total war facing it, all civil activities were subordinated to the military effort.

The Supreme Court pointed out in the *Powell* case that Congress was fully advised of this, but nevertheless undertook to preserve the distinction between shipments designed to strengthen our allies, and in that way to promote the war effort, and shipments intended for use directly in military or naval activities.

Defendant asks this court to ignore this distinction and to apply the reduced rates to commodities commonly used in civilian operations upon the ground that in World War II all Russian industrial activities were military. The complete answer is in the ruling of the *Powell*

case: that in the intepretation of Section 321(a) the distinction between "military" and "civil" which "common parlance marks" must be preserved (330 U.S. at p. 246).

Defendant also cites *Southern Pacific Company v. United States,* 67 F. Supp. 966 (Ct. Claims), cert. den. 330 U.S. 833, 67 S. Ct. 964, 91 L. Ed. 1381, which involved the shipments of motor vehicles and parts to China under Lend-Lease arrangements. However, the vehicles conformed structurally to military specifications, and the carrier did not even claim that they were for "civil" use. In the case at bar, there was no claim that any of the property was specially built or constructed to conform to military specifications.

The *Southern Pacific Company* case is also cited for the proposition that the notation on the requisitions submitted by officials of the Soviet Government Purchasing Commission (R. 28-37) as to use were "at least *prima facie* evidence of intended military use of the property" (App. Br. p. 35). However, a later decision by the Court of Claims in *Chicago and Northwestern Railway Company v. United States,* 124 F. Supp. 359, casts doubt as to whether such a statement on a requisition or bill of lading is any indication of the true character of the shipment. In that case, it was held that shipments of scrap steel owned by the government and shipped during 1944 and 1945 from West Coast shipyards to midwest steel mills were not entitled to land-grant rates even though the bills of lading contained the consignor's endorsement: "Military

or naval property of the United States moving for military or naval and not for civil use." In holding that the shipment was not entitled to land-grant rates even though the consignees were steel mills doing important defense work, the court held (124 F. Supp. at p. 361):

> "The facts clearly establish that the scrap was to be put to a predominantly civil use. It may well be that the plants here involved were doing work of importance to the defense of the country, but if that alone were a sufficient criterion a substantial distinction between military and civil uses could hardly ever be made in time of war.
>
> * * * * *
>
> "The unilateral declaration on the part of the Government that the cargo was moving for military or naval use was not sufficient to determine the question whether or not the cargo was actually so moving."

In a more recent case, *The Atchison, Topeka and Santa Fe Ry. Co. v. United States,* 130 F. Supp. 593 (Ct. Claims), cert. den. 350 U.S. 883, 76 S. Ct. 136, 100 L. Ed. 779, it was held that full commercial rates were applicable to shipments under Army bills of lading, despite the fact that each contained a statement that the articles were military property moving for military use (see 132 Ct. Claims at p. 762).

Defendant's brief emphasizes that the nature and status of the shipments should be determined at the time of the shipment. Since there was no agreement between the carriers and the defendant as to the character of the shipments involved at the time or during the course of shipment, the court necessarily has to examine the relevant data in the record on this point.

Here it is stipulated that all the shipments were made for the account of the Procurement Division, United States Treasury Department, which, under authority delegated to it by the President, had procured the property for the United States and authorized its shipment to Soviet Russia under the Lend-Lease Act (R. 6).

Therefore, the intention of the President, as expressed through his administrative agency, the Procurement Division of the United States Treasury, is of some significance in determining the character of Lend-Lease shipments.

The President's Reports to Congress on Lend-Lease Operations (Joint Exhibits 16-26) treated military equipment or "munitions" as separate from the property here involved, which fell into a separate category, labeled "Industrial Items" or "Industrial Products." In the tables in each report outlining the various categories of Lend-Lease shipments, Lend-Lease aid is broken down under the following classifications: Ordnance, aircraft, tanks, motor vehicles, watercraft, miscellaneous military equipment, and in some of the later reports these categories are lumped under "munitions." The classification of "Industrial items and products" or "Industrial materials and products" is always separate, as is the category of "agricultural products." (See, e.g., Ex. 16, p. 11; Ex. 17, p. 20; Ex. 18, p. 19; Ex. 20, p. 17; Ex. 21, p. 31; Ex. 22, p. 25; Ex. 23, p. 30; Ex. 24, p. 19; Ex. 25, p. 15 and Ex. 26, p. 21.)

Other portions of the President's Reports indicate that at all times a clear line was drawn between the

shipments of military equipment or munitions to Russia and the lend-leasing of industrial equipment and machine tools. For instance, in the report for the period ending April 30, 1943 (Ex. 17, p. 21), it was stated:

> "Shipments to Russia of military equipment have included thousands of planes, many tens of thousands of trucks, jeeps, and other military motor vehicles, hundreds of thousands of miles of field telephone wire, several million pair of army boots, and large amounts of other military supplies. Lend-lease shipments have also included hundreds of thousands of tons of armor plate, steel aluminum, copper, zinc, T.N.T., and chemicals for the production in Russia of planes, tanks and bombs; electric furnaces, presses, forging hammers, and various types of machine tools for Soviet arms factories; electric power generating equipment for Soviet war industries and quantities of rails and other supplies for railroads and communications."

In the report for the period ending July 31, 1943 (Ex. 18, p. 19), it was noted:

> "About 57 percent of the goods sent to the U.S.S.R. since the inception of the first protocol have been munitions such as airplanes, tanks and guns. We have sent more lend-lease planes there than to any other country. Large quantities of supplies for her transportation and communication systems have been sent to aid the movement of the weapons of war over vast distances to her armies at the front. We have shipped to the Soviet Union more than 100,000 tons of rails and accessories. Quantities of automatic block signal system equipment for the U.S.S.R. are in production. We have shipped more than 150,000 motor vehicles, over 600,000 miles of telephone wire and approximately 190,000 field telephones.
>
> "Shipments to the U.S.S.R. have also included thousands of tons of raw materials and machinery

to help replace the output of war plants in areas now occupied by the Nazis. Included in these shipments have been aluminum, copper, steel and large amounts of chemicals and explosives used in the manufacture of ammunition and bombs. We have purchased a few existing plants in this country and shipped them to Russia with machinery for new ones as well."

In the report for the period ending December 31, 1944 (Ex. 24, p. 21), the following statement is found:

"Before the Nazis overran the Ukraine in 1941 the Soviets themselves destroyed essential parts of the $110,000,000 Dnieperstroi Dam. The Nazis wrecked it further and other electrical plants as well, as they retreated. To provide electric power for war industries in liberated areas, we developed in this country a power train. It consists of a complete steam generating unit mounted on railroad flat cars, which can be moved from city to city or industry to industry as the need demands. As soon as the local utilities are functioning again, the power train moves on to 'spark' the industries in another district. Up to December 1, 1944 we had sent 60 of these trains and the Soviets had already put some of them to good use in the Donets Basin."

Joint Exhibit 27 entitled "Soviet Supply Protocols" shows just as clearly that military supplies falling within the category "Armament and Military Equipment" were listed in a category separate from "Various Material, Machinery and Industrial Equipment" and "Equipment and Materials for Specific Industries" (Second Protocol, pp. 19, 22, 29; Third Protocol, pp. 56, 71; Fourth Protocol, pp. 95, 96, 111). All of the shipments at bar are listed in machinery and equipment categories, rather than under the armament or military supply categories.

In the *Powell* case, the classification drawn between military and nonmilitary goods in the reports to Congress on Lend-Lease operations was deemed of the utmost significance. The district judge stated on this point (60 F. Supp. at pp. 438-439):

> "In the several reports a distinction is drawn between military and non-military goods. For example, in the report of August 24, 1944, Table No. 3, appearing on page 11, is denominated: 'Quantities of Non-Military Goods Transferred', and among other items listed fertilizer—the article with which we are now concerned. Similar instances appear at many places in the various reports and innumerable illustrations of the transfer of articles strictly for use by civilians might be shown.
>
> "It would appear that Congress adopted or approved this interpretation. The President has repeatedly reported to Congress the distribution of huge quantities of non-military and distinctly civilian goods and with these reports before it Congress has endorsed and approved this course by enabling its continuance by the enactment of the necessary appropriations acts.
>
> "The construction given to a statute by the Executive Department charged with its administration is entitled to great weight."

In affirming the judgment below, the Court of Appeals for the Fourth Circuit stated (152 F.(2d), at pp. 229-230):

> "An even stronger reason against the Government's contention is the fact that the whole history and administration of the Lend-Lease Act show definitely that two separate types of assistance were contemplated: (1) Military or naval; (2) civil. Nowhere is this more cogently shown than in the numerous reports of President Roosevelt to Congress on

just what had been done in administering the Lend-Lease Act. On the strength of these reports, Congress continued to make further Lend-Lease appropriations and no amendment of the Transportation Act was made or sought.

"A few items from these reports of the President (which could be indefinitely multiplied) must suffice. Thus Chapter 3 of the Fourth Report (pages 19-21) expressly divides Lend-Lease goods already shipped into three classes: (1) Military, (2) Industrial, and (3) Agricultural. A like classification is found in the Fifth Report (page 9). The same is true of the Seventh Report where (page 9) it is stated: 'Exports of *military* items have arisen much more rapidly than exports of *non-military* items.' (Italics ours.) The Third Report (pages 24-26) mentions the appearance of Lend-Lease Goods 'on the grocers' shelves and in the kitchens of Great Britain,' and states that 1,300,000 small children were receiving 'a regular supply of concentrated orange or black-current juice, and of cod liver oil compound.' The Tenth Report (page 20) mentions 'supplies needed to prevent a breakdown of the civilian economy.' (Italics ours.) Finally, in the Fifteenth Report (page 38) we find: '*Civilian* supplies shipped to French Africa under Lend-Lease. * * * We have sent to Tunisia and Morocco, for example, equipment to increase production of the phosphate mines. The fertilizer produced by these mines is needed both for the United Kingdom's intensive food production program and for the restoration of food production in the liberated areas of occupied Europe.' (Italics ours.)"

While the United States Supreme Court discussed other aspects of the question in affirming the decision of the lower courts in the *Powell* case, it is noteworthy that at no place in its opinion was any part of the lower courts' opinions disapproved or criticized.

II

The decision in United States v. New York, New Haven & Hartford R. Co., 355 U.S. 253, 78 S. Ct. 212, 2 L. Ed. 2d 247, is not relevant to the case at bar.

Before reviewing the facts of the *New Haven* case, it is important to note that courts customarily use the phrase "burden of proof" in two senses. This sometimes leads to confusion. As stated by this court in *Wong Kam Chong v. United States,* 111 F.(2d) 707, 710:

> "The apparent confusion has probably been caused in large part by the two meanings commonly given 'burden of proof'. Burden of proof in one sense means the duty to establish a certain fact by a certain degree of proof, such as a preponderance of the evidence, clear and convincing evidence, or beyond a reasonable doubt. In another sense it means the duty to offer evidence, or the duty to go forward with the evidence."

[See also, *Hill v. Smith,* 260 U.S. 592, 43 S. Ct. 219, 67 L. Ed. 419; *Pacific Gas & Electric Company v. S.E.C.,* 127 F.(2d) 378, 382 (CA9); *Northwestern Electric Co. v. F. P. C.,* 134 F.(2d) 740, 743 (CA9), aff'd 321 U.S. 119, 64 S. Ct. 451, 88 L. Ed. 596.]

In the *New Haven* case, the phrase "burden of proof" was used by the Supreme Court in the second sense, as to the duty of the railroad to offer evidence, or to go forward with the evidence. The railroad had won in the lower courts and the government had lost because the courts had ruled that it was incumbent upon the government to plead and prove a certain crucial fact. There the railroad brought suit in the district court to

recover in full upon a 1950 shipment, over which there was no dispute. However, pursuant to Section 322 of the Transportation Act of 1940, the government upon post-payment audit had made deductions from the 1950 bill on the ground that the railroad had overcharged the government on four 1944 transportation bills which had been paid in full. The government pleaded this deduction in its defense of partial payment of the 1950 charges.

With respect to the 1944 shipments, it appeared that the initial carrier had furnished on each occasion a freight car of greater length than that ordered, and that the New Haven, as collecting carrier, had billed at the higher rate applicable to the car furnished. This higher charge was proper only if a car of the size ordered had not been available to the carrier. As stated by the Court of Appeals (236 F.(2d) 101, 103), ". . . the availability to the carrier of certain sizes of cars became the controlling question of fact in determining the validity of the charges . . ." In other words, the carrier ordinarily should have charged at the rate applicable to the car ordered. However, if such a car was not available and could not have been furnished, then, in that event, the carrier could properly bill at the rate applicable to the car furnished.

The General Accounting Office determined the overpayment upon a finding that the documents showed that longer cars were furnished than ordered, and in answering interrogatories as to whether cars of the sizes ordered were available the government maintained that

such information was peculiarly within the knowledge of New Haven, or the initial carrier, and that it had no knowledge of the fact. Presumably, neither party had the information since the railroad's position was that the government had all the information known to the carriers as to the availability of cars of the sizes ordered (355 U.S. 253, footnote 5).

At pretrial, the district court ruled that the plaintiff need not plead or prove any of the facts relating to the 1944 shipments, and that the burden was upon the government to plead and prove the facts relating to the 1944 shipments by way of set-off. Upon this basis, the district court subsequently granted the railroad's motion for summary judgment since there was no dispute as to the 1950 shipment sued upon. On appeal, this disposition was affirmed (236 F.(2d) 101).

The Supreme Court reversed on the ground that prior to the enactment of Section 322, the government could have held up payment, and if the New Haven had been forced to sue, it would have had to prove the correctness of the 1944 charges. The court held that it was not the intent of Congress, by compelling immediate payment of freight bills by the government through the medium of Section 322, to change the burden of proof and compel the government to plead and prove facts which the carrier otherwise would have had to plead and prove.

In the *New Haven* case, the facts as to the availability of smaller cars should have been within the peculiar knowledge of the New Haven or its correspondent

initial carrier, since the availability of freight cars was a matter of railroad operations. But, more important, it was incumbent upon the carrier to prove that the type of car was not available because, otherwise, the carrier would not have been entitled to charge at the rate applicable to the car furnished. The fact as to nonavailability had to be established by the carrier before it could lawfully charge the higher rate. Therefore, the case was remanded to the district court so that the New Haven could be given an opportunity to plead and prove the facts as to the availability of the freight cars ordered.

In its opinion, the court specifically pointed out that if administrative settlement were not reached prior to the enactment of Section 322, and the carrier sued to recover the amount of the bill, no one would question that it would be the carrier's duty to sustain the burden of proving the correctness of the charges. However, in a footnote, this broad rule was distinctly qualified (355 U.S. 253, footnote 5): "The ordinary rule based on considerations of fairness does not place the burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary [citations]."

In the light of this explanation, the *New Haven* case must be understood as holding that whenever the carrier had the burden of proving the correctness of its freight charges, there would be no shift of that burden because of the Section 322 procedure. It cannot be inferred from this or from anything said in the opinion that the burden of proof would be upon the railroad when the shipper demanded a special reduced rate, and

the facts which determined whether the rate was applicable were peculiarly within the knowledge of the shipper.

Even if the doctrine of "burden of proof" were of importance in the case at bar, admittedly the Section 322 procedure is of no significance in determining which of the parties here had the burden of proof. In the *New Haven* case, the facts reviewed in the opinion make clear that the railroad had or ought to have had the information and that it was required to prove the right to the higher rate claimed.

Here, the situation is just the reverse. After the General Accounting Office audit, the government asserted the statutory exception of land-grant rates upon the ground that the commodities shipped were military or naval property of the United States moving for military or naval and not for civil use. Contrary to the *New Haven* case, the plaintiff at bar had the right to recover from the defendant the "full applicable commercial rates or charges" under Section 321(a); *except* that this provision did not apply to "the transportation of military or naval property of the United States moving for military or naval and not for civil use." Therefore, it was incumbent upon the defendant to show the existence of a state of facts entitling it to the benefit of the statutory exception.

It is a well-settled rule that a party claiming a peculiar right, which is given by statute and is given only when a prescribed state of facts shall exist, has the burden of proving the existence of the facts entitling him

to such a right (*United States v. Dickson,* 15 Pet. 141, 10 L. Ed. 689; *The Edith,* 94 U.S. 518, 24 L. Ed. 167; *Canadian Pacific Ry. Co. v. U.S.,* 73 F.(2d) 831 (CA9); *Feeley v. Woods,* 190 F.(2d) 228 (CA9); *Walling v. Reid,* 139 F.(2d) 323 (CA8); *Sherman Investment Co. v. United States,* 199 F.(2d) 504 (CA8)).

It cannot be denied that the facts which determine the validity of this claim are wholly and peculiarly within the knowledge of the defendant. The burden of proving the right to a reduced rate rested upon the government, whether asserted in the defense of an action for the tariff charges or, as here, in defense of the carrier suit to recover later deductions made from current accounts due the carrier. The *New Haven* case has made it clear that the Section 322 procedure does not affect or change the burden of proof requirement as established by these well-settled legal principles.

III

The defendant failed to comply with the condition in the export tariff that specific destination beyond Pacific Coast port of export be shown in the bill of lading issued at the time of shipment.

The sole question before the court is whether or not defendant complied with all the conditions and restrictions of Transcontinental Freight Bureau West-Bound Export Tariff No. 29-Series, so as to be entitled to through export rates thereunder on 22 shipments of Lend-Lease materials exported to the Soviet Union in 1943.

The supplemental pretrial order narrowed this question down to whether or not defendant had complied with the mandatory requirement of Item 270(a) of that tariff which specifies that the rates authorized thereunder apply "only to export traffic when specific destination beyond Pacific Coast port of export is shown in bill of lading or shipping receipt issued at time of shipment."

Defendant's principal assumption in its brief that the representative bill of lading listed the "destination" of the particular shipment as "U.S.S.R." is erroneous (App. Br. p. 10). An inspection of Exhibit 33 shows "Portland, Oregon" above the line and "(Destination)" immediately below. The notation "U.S.S.R." is found under "Marks," together with some Russian words and code marks. This is not any indication or showing of "destination," and the only destination shown on the bill is "Portland, Oregon." Therefore, no destination beyond Pacific Coast port of export is shown, but merely the Pacific Coast port itself.

Thus, the inference cannot be drawn that any shipping clerk or other railroad employee could conclusively presume that the destination of the shipment was the U.S.S.R., or within the territorial limits of the tariff. The court can take judicial notice of the fact that a substantial part of the supplies given to the Soviet Union during World War II under Lend-Lease were delivered and accepted in this country and were never exported to Russia. Examples of such materials and supplies are coal and oil which were used for refueling Soviet ships in American ports.

Five judges of the Court of Claims in the case of *Union Pacific R. Co. v. United States,* 132 F. Supp. 230, concurred in the determination that the mere notation "U.S.S.R." under "case marks" was a failure to comply with Item 270(a) on the ground that it was an insufficient showing of "specific destination." The court in its opinion stated (132 F. Supp. at p. 232):

> "As set out in our findings, the defendant did not comply with a number of conditions in connection with Items 235, 270, 285 and 290 of TCFB Export Tariff 29 Series. For these reasons the defendant is manifestly not entitled to land-grant deductions on these particular items."

The failure of the government to comply with Item 270 is explicitly set out in paragraph 33 of the court's findings (132 F. Supp. at p. 248):

> "33. The defendant failed to comply with the provisions of Item 270 of TCFB Export Tariff 29 Series, because the specific destination or destinations beyond the Pacific coast ports of export were not shown in any of the bills of lading or shipping receipts issued at the time of shipment. Although the plaintiff knew that these shipments were being exported to Russia or the United Kingdom, the specific overseas destinations were not disclosed to plaintiff and the other rail carriers in the bills of lading or by any other means.
>
> "Most of the Government bills of lading in the Group 5 category contained a reference thereon to 'case marks' on an attached sheet. Below the words 'case marks' on the attachment, there appeared the words 'Technopromimport, U.S.S.R.' After this suit was filed, the General Accounting Office learned that this marking meant that the shipment was imported from the United States by the Union of Soviet Socialist Republics, but this marking did not show the specific overseas destination."

Of principal importance in the *Union Pacific* case was the conceded fact that the form of the commercial uniform through export bill of lading prescribed by the Interstate Commerce Commission included spaces for insertion of the rail destination and the overseas port destination of the shipment (Finding No. 32, 132 F. Supp. at p. 248; see also *Export Bills of Lading,* 235 I.C.C. 63, 64). While government bills of lading were employed here, rather than commercial bills, certainly the commercial bill requirement that the specific port destination be named should be given considerable weight by the court in construing the meaning of "specific destination."

Defendant implies that the construction of Item 270(a) was only a minor issue which was not given any real consideration by the Court of Claims. However, a mere reading of the opinion which, of course, includes the court's Findings of Fact, shows the contrary. The court found noncompliance with a number of items in the export tariff "As set out in our findings" (132 F. Supp. at p. 232). The findings on this question are detailed and explicit (132 F. Supp. at p. 248). The court also stated in its opinion (132 F. Supp. at p. 232):

> "The Group 5 bills which are in issue cover a great many shipments. The complete statements of the facts in reference thereto are set out in findings 18 to 36 inclusive. We can see no good purpose to be served in repeating in detail the facts set out in those findings. They include items 235, 270, 285 and 290."

While defendant argues that the decision of the Court of Claims is of "scant precedential value," it may

be noted that in the very recent case of *United States v. Missouri Pacific R. Company,* 250 F.(2d) 805 (CA5), relied upon by defendant here, the appellate court, on one point in the case, noted that the precise question had been correctly decided by the Court of Claims. The Court of Appeals disposed of the issue summarily "upon the considerations and for the reasons stated in that opinion" (250 F.(2d) at p. 808). The same considerations would appear to govern this court's review of the export rate question, particularly since the government accepted the decision of the Court of Claims in the *Union Pacific* case and did not seek a review by the United States Supreme Court.

On this point, the observation of Judge Prettyman of the United States Court of Appeals of the District of Columbia Circuit in *Land v. Dollar,* 190 F.(2d) 366, 379, cert. dismissed 344 U.S. 806, 73 S. Ct. 7, 97 L. Ed. 628, is most pertinent:

> "There are almost always two sides to a controversy. The loser almost always thinks the court is wrong. The Department of Justice in this instance, although supposed to set the standard for the attitude and conduct of the bar toward the bench, appears upon the papers thus far before us to vent this well-nigh universal dissatisfaction at defeat by instigating an unseemly conflict between two courts, either of which might have had initial jurisdiction of the cause."

Plaintiff agrees that the interpretation of tariff items should be susceptible of practical and ready application. However, it is well settled that terms used in a tariff must be taken in the sense in which they generally are understood and accepted (*Chicago B & Q Ry. Co. v. United*

States of America, 221 F.(2d) 811, 812 (CA7)). Therefore, it is pertinent to consider the definition of "specific" as taken from Webster's New International Dictionary (2d Ed. 1942), p. 2414:

> "Precisely formulated or restricted; specifying; definite or making definite; explicit; of an exact or particular nature; as, a 'specific' statement."

Finally, defendant argues that Items 270(a) might violate Section 1(6) of the Interstate Commerce Act if construed to prohibit defendant from taking advantage of the export rate. This contention would seem quite farfetched in view of the decision of the Interstate Commerce Commission in *War Materials Reparation Cases,* 294 I.C.C. 5, holding that certain export tariff rules, including Item 270(a), were not unjust or unreasonable as applied to the government's wartime shipments. The construction given to Item 270(a) by the Court of Claims is supported by the Interstate Commerce Commission's decision in the reparation cases. In outlining the principal reason for this requirement in Item 270(a), the Commission stated (294 I.C.C. at p. 43):

> "The principal reason for requiring in item 270 that the oversea destination be shown by the shipper was that in meeting competition of the Atlantic and Gulf port routes, embracing ocean lines from those ports directly to the particular oversea destinations, the railroads required knowledge of the destination to identify the transcontinental traffic as in fact tendered for movement to such destination. The requirement that the destination be shown in billing at time of shipment also helped to prevent the application of export rates to shipments that would move freely on the higher domestic rates.

There was no occasion to apply the lower export rates on a shipment forwarded to a Pacific port without knowing its ultimate disposition and only in anticipation of a sale, after arrival at the port, at some indefinite point in the Pacific area. The competition at an oversea destination which warranted such rates would be lacking, and in such circumstances the railroads sought to secure their domestic rates, many of which, as elsewhere stated herein, were severely depressed.

"The complainant contends that in the interest of military security it was impossible to show the specific destinations of its shipments. Conceding the validity of this claim, this circumstance must also be regarded as further convincing proof of the true character of its shipments which plainly were distinguishable from export shipments."

The shipments at bar would appear to fall within the category of the "relatively small amount of lend-lease shipments" which were held by the Commission in the *War Materials Reparation Cases* not to have complied with Item 270(a) (294 I.C.C. at p. 28):

"*Disclosure of specific overseas destination.*— Most of the shipments consisted of war material and supplies consigned to Army or Navy installations at or near Pacific coast ports by direction of the War or Navy Departments. They included a relatively small amount of lend-lease shipments handled through the ports of San Francisco and Los Angeles and nominal amounts for account of other governmental agencies. Most of this material moved westward from transcontinental origins without knowledge by the Government at time of shipment, and, as to much of it, at the time of arrival at the port, of where it would be used although it was anticipated generally that it would be used in the war effort, primarily in the support of troops or naval operations somewhere in the Pacific area, including

> the Pacific Coast States, Alaska, the island of the Pacific, Australia, or Asiatic countries, whenever and wherever dictated by the exigencies of war. Because of the shortage of available ocean shipping space the rail movement was generally directed to the port from which the overseas movement by vessel would be the shortest, in the eventuality of such movement."

Thus, the bill of lading and the stipulated facts show that the destination of these government rail shipments was "Portland, Oregon," and that they were later exported by ocean carrier to Russia. However, these facts are insufficient to make the export tariff applicable. Very recently, the Interstate Commerce Commission stated in *United States v. Western Pacific Railroad Company* (April 21, 1958, Docket No. 32152, sheet 6): ". . . rates set forth in tariff 29 series were not applicable to rail shipments of government property destined to Pacific ports and later transshipped by sea. The situation was fully described on pages 35-39 of the report in *War Materials Reparation Cases,* supra."

At the close of its brief (App. Br. p. 48, footnote 19), defendant states that a 1944 tariff change in Item 270(a) which deleted the word "specific" (R. 46, Ex. 36) cannot "serve as an aid in construing Item 270(a) as actually written." It is to be noted that the government's position on this point is contrary to its brief in the *Union Pacific* case on its motion for a new trial, where it was stated (p. 7):

> "By Supplement No. 14 to TCFB Tariff 29-G, effective May 15, 1944, the word 'specific' in Item 270 was eliminated so that it was no longer required that the destination shown on the bill of lading be

> 'specific.' While these amendments became effective after the pertinent shipments here involved were made in 1942 and 1943, they serve to throw some light on the construction and intention of the language before amended."

Plaintiff respectfully submits, with all deference due the Department of Justice as the agency of the United States charged with the administration of justice, that the attempt by the government in this controversy to relitigate the export tariff question decided adversely to it by both the Court of Claims and the Interstate Commerce Commission is indefensible and should not be permitted.

CONCLUSION

Plaintiff respectfully submits that the judgment below should be affirmed in all respects.

Respectfully submitted,

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No. 15852

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT

v.

SPOKANE, PORTLAND AND SEATTLE RAILWAY COMPANY, A CORPORATION, APPELLEE

On Appeal from the United States District Court for the District of Oregon

REPLY BRIEF FOR APPELLANT

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CITATIONS

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REPLY BRIEF FOR APPELLANT

In this reply brief, we discuss separately appellee's contentions on the three issues which are raised by this appeal: (1) whether the court below properly placed the burden on the United States to disprove the correctness of appellee's claims; (2) whether the undisputed evidence adduced by the Government established that the shipments were entitled to the land-grant rate; and (3) whether there was compliance with the condition in the export tariff that specific destination beyond Pacific Coast port of export be shown.

1. *The burden of proof.* In urging in our main brief (pp. 17-23) that the court below erroneously relieved appellee of the burden of proving the correctness of its claims against the United States, we pointed to the recent decision of the Supreme Court in *United States* v. *New York, New Haven & Hartford R. Co.*, 355 U.S. 253, as well as to *United States* v. *Missouri Pacific R. Co.*, 250 F. 2d 805 (C.A. 5). In the *New Haven* case, the Supreme Court expressly held: (1) that, before the enactment of Section 322 of the Transportation Act of 1940, "it was the carrier's duty to sustain the burden of proving the correctness of [its] charges" (355 U.S. at 256); (2) that the right conferred upon the United States in Section 322 "to deduct overpayments from subsequent bills was the carriers' own proposal for securing the Government against the burden of having to prove the overpayment in proceedings for reimbursement" (355 U.S. at 260); (3) that "the Government's statutory right of set-off was designed to be the substantial equivalent of its previous right to withhold payment altogether until the carrier established the correctness of its charges" (355 U.S. at 261); and (4) that, as a consequence, "the burden of the carrier to establish the lawfulness of its charges is the same under §322 as it was under the superseded practice" (355 U.S. at 262). In the *Missouri Pacific* case, this holding was relied upon by the Fifth Circuit in determining that the carrier had the burden of proof on the issue of the weight of a government shipment of airplane fuselages (the resolution of the conflicting claims on that issue being

essential to a determination as to the correctness of the carrier's charges).

Notwithstanding *New Haven*, appellee renews (Br. pp. 29-34) the contention it made in the court below that it did not have the burden of demonstrating that its charges on the shipments here involved were proper—that, instead, it was incumbent upon the Government to show that appellee was not entitled to recover the amount it claims. It appears to suggest that the Supreme Court's holding in *New Haven* has application only where the facts necessary to the resolution of the critical issue are within the peculiar knowledge of the carrier. It also argues that the burden of proof would have been on the Government in this case had the pre-payment audit procedure been still in effect when the transportation services were performed.

(a) The lack of merit to appellee's endeavor to limit the scope of the *New Haven* decision becomes plain from even a cursory reading of the Supreme Court's opinion. At no point did the Court either state or imply that its conclusion respecting the assessment of the burden of proof was based upon any consideration other than that Section 322 was not intended to change the long-established rule that carriers (in common with all other contractual claimants against the Government) must furnish evidence satisfactorily establishing their claims. If there were room for possible doubt in this regard, and we submit there is none, it would be totally dispelled by footnote 5 (355 U.S. at 256), quoted in part by appellee at page 32 of its brief. In that footnote, the Court

referred to the conflicting claims of the parties with respect to whether the information as to the availability of the ordered cars was peculiarly within the carrier's knowledge—but expressed no opinion itself on the merits of the respective positions. If the Court had thought that the matter was of relevance to the disposition of the cause (let alone of controlling importance), it obviously would have undertaken to resolve the disagreement either at that point or at some subsequent point in the opinion.

(b) There are at least two complete answers to appellee's endeavor (Br. pp. 32-34) to distinguish the *New Haven* case on the ground that the Government is here demanding "a special reduced rate" and that a party claiming a "peculiar right" must prove the facts entitling him to assert that right. In the first place, there is no basis for this characterization of the land-grant rate. At the time these shipments were made, that rate had long been a firmly established feature of the rail transportation of Government property. See *United States* v. *Powell*, 330 U.S. 238, 240-241, and cases there cited. Further, during World War II a substantial percentage, if not the overwhelming majority, of Government rail shipments were military or naval property moving for a military or naval use—with the result that the application of the land-grant rate was then the rule rather than the exception.

Appellee's argument is closely akin to that which the carrier unsuccessfully made in *Northern Pacific Ry. Co.* v. *United States*, 330 U.S. 248. As we noted in our main brief (p. 31), the carrier there—like

this appellee—pointed to the supposedly remedial character of Section 321(a) of the Transportation Act and urged that "it should be liberally construed so as to permit no exception [to the application of the commercial rate] which is not required." The Supreme Court's response [330 U.S. at 257] was a reference to the "familiar" rule, invoked in the past in construing the reduced rate conditions of land grant legislation, that "any doubt as to the meaning of a statute which 'operates as a grant of public property to an individual, or the relinquishment of a public interest' * * * should be resolved in favor of the Government and against the private claimant." The Court went on to note that Section 321(a) "was in essence merely a *continuation* of land-grant rates in a narrower category." [Emphasis supplied.]

Secondly, even if Section 321(a) could be regarded as conferring a "peculiar" right upon the Government, it is difficult to see how appellee's position would be advanced. Contrary to appellee's assertion (Br. p. 32), the Government has made no "demand" in this action. Rather, appellee is the claimant. Before the court below was *its* claim to public funds, grounded upon *its* theory that it had a contractual and statutory entitlement to the full amount of the bill *it* rendered the Government. Its obligation to show such entitlement perforce was precisely the same as the obligation of the carriers in the *New Haven* and *Missouri Pacific* cases to prove their right to the public monies which they claimed.

(c) There is no greater substance to appellee's assertion (Br. pp. 32-34) that the Government seeks

to require it to adduce evidence on matters as to which the Government was in exclusive possession of the relevant factual information. Certified copies of all the requisitions of the Soviet Government Purchasing Commission, pursuant to which the shipments had been made, were made available to appellee and were produced at the pre-trial (R. 21-24). Additionally, without waiting for appellee to introduce any evidence whatsoever, the Government furnished the testimony of both King and Faymonville. These individuals (1) had played prominent roles in the area of Soviet procurement under the Lend-Lease Program; (2) in the performance of their official duties had become thoroughly familiar with Soviet military needs; and (3) had discussed the intended use of the requisitioned equipment with Soviet officials. Indeed, Faymonville had been in charge of the American Supply Mission to the Soviet Union.

In these circumstances, it can be fairly said that, at the time of trial, appellee's knowledge of the intended use of the equipment by the Soviet Union was co-extensive with that of the Government. It knew just what the Government knew: that the Soviet Union had requisitioned the equipment to fulfill a critical military need and that the American officials responsible for the procurement program had honored the requisitions with that understanding.

2. *The land-grant rate.* In its brief (p. 13), appellee disputes the observation in our main brief that the court below had taken the test to be whether the shipped property, or the products thereof, were employed against the enemy. It suggests that, instead,

the court held that the shipments were not "military or naval property * * * moving for military or naval and not for civil use" because it did not believe that the entire economy of the Soviet Union was geared to the prosecution of the war.

We do not think that the court's opinion (R. 38-40) is susceptible of appellee's interpretation. The opinion states Judge Fee's belief that the nature of the Soviet economy was irrelevant—that the issue in litigation was whether the shipments were military property moving for a military use within the meaning of Section 321(a). And this question was resolved in the negative on the ground that "[t]here is very little indication in the record that any of this property ultimately was used on or near the battleground or that any of the products of any of the machinery ever were devoted to use against the common enemy" and that "[t]he government did not prove that any single article shipped or any single article or product of these machines actually was devoted to a war use." These observations were thereafter reiterated by the court in its findings of fact (which made no reference whatsoever to the Soviet economy) (R. 59-60).

In any event, what is of present significance is that appellee is in apparent agreement with the position taken in our main brief (pp. 23-28) that the only appropriate inquiry is into whether the property had an intended military use at the time that the rail movement took place. Accordingly, we turn now to appellee's contentions on the matter of what represents a military use.

Appellee's entire discussion is bottomed on the premise that the Government's theory is that the absence of a civil economy in the Soviet Union during World War II meant that all lend-lease shipments to that country of necessity were military in nature. As we think our main brief makes clear, this premise is erroneous.[1] What we have consistently urged, instead, is that, in determining whether particular shipments of lend-lease property were intended for military (as opposed to civil) use for the purposes of Section 321(a), reference must be made to the criterion of military use which was laid down by the Supreme Court in *Northern Pacific Ry. Co.* v. *United States*, 330 U.S. 248, and subsequently applied by this Court and the Court of Claims. That criterion was this [330 U.S. at 254-255]:

> Military or naval use includes all property consumed by the armed forces or by their adjuncts, all property which they use to further their projects, all property which serves their many needs or wants in training or preparation for war, in combat, in maintaining them at home or abroad, in their occupation after victory is won. It is the relation of the shipment to the military or naval effort that is controlling under Section 321(a).[2]

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[1] Appellee will search in vain for a single reference in our main brief to the lack of a civil economy in the Soviet Union.

[2] Appellee dismisses (Br. p. 16) the *Northern Pacific* case on the ground that it did not involve shipments under the Lend-Lease Act. *United States v. Powell*, 330 U.S. 238, however, dispels any doubt that this distinction is without substance. In that case, which *did* involve lend-lease shipments,

As shown in more detail in our main brief (pp. 7-8, 36-39), the testimony of Faymonville and King reflected unmistakably that the shipments in this case were intended for either direct use by the Soviet armed forces or for the manufacture of materials for those armed forces—and thereby supported the statements of intended military use contained in the requisitions themselves. For example, the mobile power stations were to supply electricity to the Soviet army—not to some civilian agency engaged in producing articles for civilian consumption (R. 86-88). Similarly, both the hydroelectric and steel plants were intended for use in the manufacture of munitions, tanks and other implements of war which serve solely military purposes and hardly can be regarded as bolstering the over-all economy of a country (R. 86, 96-97, 102-103). Insofar as the petroleum refineries are concerned, King testified without contradiction that they were specially designed to produce that type of gasoline which was utilized in military aircraft alone (R. 123-126, 131).

In these circumstances, we fail to see the basis for appellee's assertions (Br. pp. 19, 21) (1) that "the shipments 'in common parlance' were civil and not military"; and (2) that the Government asks this Court "to apply the [land-grant] rates to commodities commonly used in civilian operations." The short of the matter is that in the "common parlance" of *all*

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the Court noted (330 U.S. at 247) that "in *Northern Pacific R. Co. v. United States, supra,* we develop more fully the breadth of the category of 'military or naval property' of the United States 'moving for military or naval use.' "

nations, the production of munitions and gasoline for combatant aircraft is deemed production for a military purpose, and not a conventional "civilian operation."

These considerations point up the inappropriateness of appellee's reliance on *United States* v. *Powell*, 330 U.S. 238. In *Powell*, decided the same day as *Northern Pacific*, the property was held by the Supreme Court to be moving for a civil use, within the meaning of Section 321(a), because the *Northern Pacific* test had not been met. The Court expressly noted that the fertilizer shipments there involved were destined for use by civilian agencies in the production of foodstuffs for civilian consumption, not for use either by the armed forces of Great Britain or by those civilian agencies of the British Government which directly served their needs. 330 U.S. at 247. There can be no question that the result in *Powell* would have been quite different had the shipments been foodstuffs for the use of the British army itself.

No more appropriate is appellee's reliance (Br. pp. 24-26) upon the various reports of the President to Congress on lend-lease operations. In none of those reports was there the slightest suggestion that the shipments were not intended for military use, within the meaning of *Northern Pacific*. It may well be that the property was described in the reports as industrial equipment—which, is, after all, precisely what most of it was. But, as appellee concedes (Br. p. 16), the *Northern Pacific* case involved shipments of bowling alleys, lumber, asphalt and other articles "which would [not] be classified as military." [3] We stress again

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[3] See also the Court's observation that "[p]encils as well as rifles may be military property". 330 U.S. at 254.

that the test is not what the article *is*, but rather what use is intended to be made of it following the rail movement. And, the portions of the reports quoted by appellee (as well as the balance of those reports and the others in evidence) provide additional confirmation of the intent of both the United States and the Soviet Union that the shipments be used either by the Soviet army or in the fulfillment of that army's need for aviation gasoline, tanks and the like.[4]

3. *The export rate.* (a) In our main brief (pp. 39-45), we demonstrated that the notation "U.S.S.R." on the representative bill of lading (Exhibit 33) gave appellee all the information that the "specific destination" condition of Item 270(a) was designed to afford it—and that the addition of the port in the Soviet Union would have constituted mere surplusage. Nowhere in its brief does appellee attempt to refute that showing. Instead, it argues that the United States should be denied the export rate solely because the notation appeared under "Marks" on the bill of lading, instead of above the word "Destination".

This argument is, we submit, footless. Leaving aside the fact that Item 270(a) does not specify where, or in what manner, the overseas destination is to be shown on the bill of lading, appellee itself is well aware that the "U.S.S.R." notation in no circumstances could have been put where it now contends the government should have put the notation.

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[4] Exhibit 13, for example, shows the understanding of the Lend-Lease Administrator that the hydroelectric plants had been requisitioned to supply power to the new munitions plants in the Ural Mountain area.

Further, appellee cannot dispute in good conscience that the presence of the notation under "Marks", especially when taken in conjunction with the other statements on the bill of lading, plainly indicated to its agents that the overseas destination was the Soviet Union.

A bill of lading is, of course, a contract for the transportation of a shipment between certain points. As such, it must reflect, among other things, precisely where the movement is to begin and where it is to terminate. Thus, the standard government bill of lading reads in part:

> Received from ..... by
> (Consignor)
> the ..... the public
> (Name of Transportation Company)
> property hereinafter described, in good order and condition (content and value unknown) to be forwarded subject to conditions stated on the reverse hereof, from ..... to
> (Shipping Point)
> ..... by the said company
> (Destination)
> and connecting lines, there to be delivered in like good order and condition to .....
> (Consignee)
> .....
> Via .....
> (Route journey only when some substantial interest of the Government is subserved thereby)

In this case, the bill of lading destination was Portland, Oregon; *i.e.*, appellee and its connecting carriers had contracted only to deliver the shipment to the consignee at that port for exportation under a separate and distinct ocean bill of lading. As a

consequence, Portland was necessarily inserted in the space provided for the bill of lading destination.[5] And, in the space provided for the identification of the consignee, the following was inserted: "Soviet Government Purchasing Commission, c/o Moore & McCormack, Inc. 506 S.W. Sixth St."

Even if this had been all that had appeared in the bill of lading, appellee's agents would have been on at least some notice that the shipments were destined for the Soviet Union. It may be, as appellee suggests (Br. p. 35), that coal and oil were occasionally delivered to the Soviet Government under the Lend-Lease Program for the refueling of Soviet vessels in American ports. It is difficult to envisage, however, an American use to which the Soviet Government could have put armored, lead covered, copper electric cable (the commodity which was shipped under the representative bill of lading).

But the bill of lading did not call upon appellee to make any assumptions as to the eventual destination of the shipments. The "U.S.S.R." notation entered under "Marks" apprised appellee that each of the boxes in which the cable was packed had a destination marking of "U.S.S.R."—*i.e.*, that the cable was to be exported to that country after the rail movement terminated at Portland. Moreover, the bill of lading contained the additional notation "For export", as

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[5] Had "U.S.S.R." been substituted for "Portland", the initial carrier would obviously not have accepted the bill of lading. To have accepted it would have meant that the rail carriers would have been obliged to deliver the shipment to the Soviet Union.

well as the Office of Defense Transportation block permit number which indicated to appellee that ocean vessel space had already been allocated for transportation to the Soviet Union.

In the final analysis, then, appellee is endeavoring to deprive the Government of the export rate specified for export tariff to all points within the Soviet Union on shipments which: (1) were marked from the inception of the rail transportation with a Soviet Union destination; (2) were transported under bills of lading which referred to those destination markings and to the export character of the movement; and (3) were actually exported to the Soviet Union.

(b) Appellee also insists (Br. pp. 37-38, 42) that the Government is precluded from questioning the correctness of *Union Pacific* v. *United States*, 132 F. Supp. 230, in which the Court of Claims held—without discussing the point—that a notation similar to that here in issue was an insufficient showing of specific destination. In this connection, it points to the fact that (1) the Government did not file a petition for a writ of certiorari in the *Union Pacific* case; and (2) that the Fifth Circuit in *United States* v. *Missouri Pacific R. Co.*, 250 F. 2d 805, followed a decision of the Court of Claims in resolving one of the questions raised in that case.

We doubt that there are many, if any, circumstances in which the failure to seek Supreme Court review of an adverse decision in one court will operate to foreclose a litigant from challenging the correctness of that decision in a different case in another

court.[6] In any event, there is no warrant for resort to any such novel estoppel doctrine here. The Court of Claims determined in *Union Pacific* that there had been a failure of compliance with *a number* of the conditions contained in the export tariff. See our main brief, pp. 46-47. If the court was right in its conclusion respecting any *one* of these conditions, its ultimate conclusion that the Government was not entitled to the export rate would have been invulnerable to attack even if its conclusions as to *all* of the other conditions were erroneous.

Insofar as the *Missouri Pacific* case is concerned, the Fifth Circuit was there confronted with an entirely different issue from that here presented; namely, whether Section 322 deductions of overpayments on Commodity Credit Corporation shipments must be made by the Comptroller General within six years after the transportation services were performed. And while the court resolved the issue in the same way as had the Court of Claims in an earlier case, it did not do so because it believed that Court of Claims' decisions are entitled to conclusive weight. Rather, the Fifth Circuit made it plain [250 F. 2d at 808] that it had passed independent judg-

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[6] In quoting (Br. p. 38) from *Land* v. *Dollar*, 190 F. 2d 366 (C.A.D.C.), certiorari dismissed, 344 U.S. 806, appellee neglects to mention that there, as Judge Prettyman viewed it, the Government had sought to nullify a decree entered by the District of Columbia Circuit by obtaining an order from the District Court for the Northern District of California enjoining Dollar from obtaining compliance with that decree. In these circumstances, the quoted portions of the court's opinion have absolutely no pertinence here.

ment on the question and had concluded that the Court of Claims was right "for the *reasons* stated in that [court's] opinion." [Emphasis supplied.]

Since the Court of Claims stated no reasons in the *Union Pacific* case, it is impossible for this Court to ascertain what considerations led it to the conclusion that there was non-compliance with Item 270(a). One thing, however, is certain. If, as appellee suggests (Br. p. 37), the court was influenced by the requirement that a *uniform through export bill of lading* must show the overseas port of destination, that conclusion is entitled to no weight at all.

A through export bill of lading, although issued by a rail carrier, covers *both* the rail movement of the goods to the port of exportation and the ocean transportation thereafter to the overseas destination. It is for this reason that that type of bill of lading has a space for the insertion of the overseas port of destination—the participating carriers must know, of course, exactly where to deliver the shipment. Stated otherwise, the prescribed insertion of the port in a through export bill of lading has no relationship to the "specific destination" condition contained in Item 270(a)—which, as construed by the Interstate Commerce Commission, requires simply a showing (not necessarily on the bill of lading itself) that the shipments are bound for a destination west of the 170th Meridian, West Longitude, and east of the 30th Meridian, East Longitude. See our main brief, pp. 42-45.

(c) Finally, nothing in the *War Materials Reparation Cases*, 294 I.C.C. 5, supports appellee's assertion

(Br. pp. 39-41) that the Interstate Commerce Commission has decided the question here involved adversely to the Government.[7] Indeed, for the reasons set forth in our main brief (pp. 42-44), the Commission's decision in actuality supports the Government's position that the "U.S.S.R." notation constituted full compliance with Item 270(a).

CONCLUSION

For the reasons stated above, and in our main brief, it is respectfully submitted that the judgment below should be reversed.

GEORGE COCHRAN DOUB,
Assistant Attorney General.

C. E. LUCKEY,
United States Attorney.

ALAN S. ROSENTHAL,
Attorney,
Department of Justice.

JUNE 1958

[7] Appellee's attempt to analogize the shipments in this case to those described in the portion of the Commission's opinion which is quoted (Br. pp. 40-41) disregards the fact that the former were destined for the Soviet Union, and space had been allocated for their ocean transportation to that country, before the rail movement began. See pp. 13-14, *supra*.

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No. 15869

United States
Court of Appeals
for the Ninth Circuit

ALBERS MILLING COMPANY, a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Transcript of Record

Appeal from the United States District Court
for the Southern District of California,
Central Division

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—2-27-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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* Page numbers appearing at bottom of page of Original Transcript of Record.

In the District Court of the United States, Southern District of California, Central Division

No. 20216PH

ALBERS MILLING COMPANY, a Corporation,
Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant.

COMPLAINT FOR REFUND OF TAXES

Plaintiff complains of Defendant and alleges as follows:

I.

Plaintiff, Albers Milling Company, at all times herein mentioned was and is now a corporation duly organized and existing under the laws of the State of Oregon, and qualified to do business in the State of California, with its general offices and principal place of business located in the City of Los Angeles, County of Los Angeles, State of California, within the jurisdiction of this Court.

II.

This Court has jurisdiction of this cause under the provisions of Title 28, United States Code, Section 1346 (a).

III.

During the period July 7, 1950, to October 31, 1950, Plaintiff shipped various quantities of its

goods and merchandise between [2] points in the United States over the lines of various railroads, and paid by check delivered in Vancouver, British Columbia, Dominion of Canada, to their agent or agents there situated, the freight charges regularly charged by said railroads for such shipments. In addition to said freight charges, said railroads wrongfully demanded and collected from Plaintiff the tax upon the transportation of property imposed by Section 3475 of the Internal Revenue Code of 1939 as then in effect. Said tax was based upon said freight charges and was paid by Plaintiff at the same time and place as the respective freight charges were paid. The names of said railroads and the amounts of transportation taxes alleged to have been erroneously and illegally collected by them from Plaintiff is as follows:

Name and Head Office Address of Railroad	Tax Erroneously Collected
Southern Pacific RR. 65 Market St., San Francisco 5, Calif.	$16,189.57
Union Pacific RR. 120 Broadway, New York 5, N. Y.	2,946.30
Northern Pacific Ry. 176 E. 5th St., St. Paul 1, Minn.	4,050.60
Chicago, Milwaukee, St. Paul & Pacific RR. 516 W. Jackson Blvd., Chicago 6, Ill.	1,293.64
Spokane, Portland & Seattle Ry. 1101 N. W. Hoyt St., Portland 7, Ore.	1,086.79

Oregon Electric Ry. 1101 N. W. Hoyt St., Portland 7, Ore.	5.04
Pacific Motor Trucking Co. 65 Market St., San Francisco 5, Calif.	4.11
Great Northern Ry. 175 E. 4th St., St. Paul 1, Minn.	2,451.79
Total	[3] $28,027.84

IV.

Plaintiff is informed and believes that, and on that ground alleges that each of said railroads paid the entire sum collected by each as a tax as aforesaid to the Collector of Internal Revenue in their respective Collection Districts as follows:

Railroad	Paid to Collector of Internal Revenue at:
Southern Pacific RR.	San Francisco, California
Union Pacific RR.	Omaha, Nebraska
Northern Pacific Ry.	St. Paul, Minnesota
Chicago, Milwaukee, St. Paul & Pacific RR.	Chicago, Illinois
Spokane, Portland & Seattle Ry.	Portland, Oregon
Oregon Electric Ry.	Portland, Oregon
Pacific Motor Trucking Co.	San Francisco, California
Great Northern Ry.	St. Paul, Minnesota

and that neither the whole nor any part of said sums has been refunded to any of said railroads by Defendant.

V.

The collection of said sums and the payment thereof to the respective Collectors of Internal Revenue was erroneous and illegal because Section 3475 of the Internal Revenue Code of 1939, as then in effect, imposed the tax only upon the amount paid within the United States for the transportation of property, whereas the amounts paid for the transportation of property, the tax upon which is here in dispute, were paid in the Dominion of Canada.

VI.

On or about August 4, 1953, Plaintiff duly filed with the District Director of Internal Revenue in Los Angeles, California a claim for refund of the full amount of the aforesaid taxes illegally collected by the said railroads, plus interest. The claim was for the sum of $29,299.35 plus interest. [4]

VII.

By letter dated July 23, 1954, the District Director of Internal Revenue in Los Angeles advised Plaintiff that its claim for refund had been disallowed in full.

VIII.

Of the amount of $29,299.35 demanded on the claim, Plaintiff is here bringing suit for $28,027.84, plus interest, as aforesaid, and Plaintiff waives recovery of the balance of $1,271.51.

IX.

No part of said sums has been repaid to Plaintiff

by the respective railroads or by the Defendant to the Plaintiff and Plaintiff has not consented to the allowance of credit or refund of any of said sums to the respective railroads.

X.

By reason of the foregoing, Defendant has become and is indebted to the Plaintiff in the amount of $28,027.84, together with interest thereon as provided by law.

XI.

Plaintiff is and always has been the sole owner of the claim referred to herein, and has not assigned or transferred the whole or any part thereof or interest therein.

Wherefore, Plaintiff prays judgment against Defendant for the sum of $28,027.84, together with interest, as provided by law, together with Plaintiff's costs of court incurred herein and such other and further relief as to this Court may seem proper and just.

Dated this 18th day of July, 1956, at Los Angeles, California.

JOHN H. MAYNARD,
ROBERT W. DRISCOLL,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff. [5]

[Endorsed]: Filed July 18, 1956.

[Title of District Court and Cause.]

ANSWER

The defendant, the United States of America, by its attorney, Laughlin E. Waters, Esquire, United States Attorney in and for the Southern District of California, denies all allegations of the complaint not admitted, qualified or otherwise referred to below.

The defendant further answers as follows:

First Defense

As its first defense defendant asserts that venue for the instant suit does not lay within the Southern Judicial District of California. According to paragraph 2 of the complaint the action is brought under Section 1346(a), Title 28, United States Code. Plaintiff is a corporation organized and existing under the laws of the State of Oregon. (See paragraph 1 of the complaint.) Section 1402(a), Title 28, United States Code, provides that a civil action against the United States brought, as here, [6] under 28 U.S.C., Section 1346(a) may be brought only in the judicial district where the plaintiff resides. Thus, venue for this suit lays only in the Judicial District of Oregon, the District of plaintiff's residence.

Accordingly, it is respectfully urged that this Court, under the provisions of 28 U.S.C., 1406(a), either dismiss this action or, if it be in the interest of justice, transfer it to the District of Oregon.

Second Defense

1. Denies the allegations of paragraph 1 of the complaint but admits that plaintiff was during all times material to this action and is now a corporation duly organized and existing under the laws of the State of Oregon.

2. Denies the allegations of paragraph 2 of the complaint.

3. Avers that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 3 of the complaint but admits that during the period July 7, 1950 to October 31, 1950 plaintiff shipped certain of its property by domestic rail and motor carrier between points within the United States. Defendant further admits that included in the various carriers' charges for these transportation services was the 3 per cent Transportation Tax imposed by Section 3475, Internal Revenue Code of 1939. Finally, defendant admits that plaintiff paid the carriers' charges, including the tax referred to, by having one of its employees travel to Vancouver, B. C. and there deposit with the domestic carriers' Canadian agents checks drawn on plaintiff's accounts located in both domestic and Canadian banks.

4. Avers that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 4 of the complaint. [7]

5. Denies the allegations of paragraph 5 of the complaint.

6. Admits the allegations of paragraph 6 of the

complaint except that it denies that plaintiff is entitled to recover on any of the grounds set forth in said claim for refund and denies all allegations of fact contained therein except those expressly admitted herein.

7. Admits the allegations of paragraph 7 of the complaint.

8. Admits the allegations of paragraph 8 of the complaint.

9. Avers that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 9 of the complaint.

10. Denies the allegations of paragraph 10 of the complaint.

11. Avers that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 11 of the complaint.

Wherefore, the defendant prays that the complaint be dismissed and that judgment be entered in its favor with costs against the plaintiff.

LAUGHLIN E. WATERS,
United States Attorney,
EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division,
JOHN G. MESSER,
Assistant U. S. Attorney,
/s/ JOHN G. MESSER,
Attorneys for Defendant,
United States of America. [8]

Affidavit of Service by Mail Attached. [9]

[Endorsed]: Filed September 18, 1956.

[Title of District Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective counsel, without prejudice to the rights of any party herein to introduce additional evidence not inconsistent herewith, and without prejudice to their right to object to the materiality or relevancy of any of the facts agreed to, during the periods involved in this action, as follows:

1) Albers Milling Company, the Plaintiff, at all times herein mentioned was and is now a corporation duly organized and existing under the laws of the State of Oregon.

2) Plaintiff is qualified to do business in the State of California and has its general offices and principal place of business in the City of Los Angeles, County of Los Angeles, California.

3) During the period from July 7, 1950 to [9-A] October 31, 1950 the Plaintiff shipped various quantities of its goods and merchandise between various points in the United States over the lines of Southern Pacific Railroad, Union Pacific Railroad, Northern Pacific Railway, Chicago, Milwaukee, St. Paul & Pacific Railroad, Spokane, Portland & Seattle Railway, Oregon Electric Railway, Pacific Motor Trucking Company and Great Northern Railway. All such shipments originated and terminated within the United States. These railroads, including Pacific Motor Trucking Company, sent their bills

for freight for the aforesaid shipments to the Plaintiff at its offices in the United States. These bills, together with the checks of the Plaintiff in payment thereof, were mailed by the Plaintiff to the office of Carnation Company, Limited, an affiliated company, in Vancouver, British Columbia, Dominion of Canada. A full-time bona fide employee of one of Plaintiff's feed stores, Mr. D. L. Grout, traveled twice each week from Bellingham, Washington, to Vancouver, British Columbia, picked up the freight bills and the checks for the payment thereof at the office of Carnation Company, Limited and presented them to the agents of the aforesaid carriers in Vancouver, who accepted the checks in payment and recorded the bills as paid. Plaintiff's only purpose in mailing checks in payment of said bills to its Canadian affiliated company and in having Mr. Grout travel from Bellingham, Washington, to Vancouver, British Columbia, and to deliver said checks in payment of the freight bills to Canadian agents of said carriers in Canada was to save transportation taxes.

4) The railroads also added to the amounts of their freight bills and demanded from Plaintiff payment of the federal tax upon the transportation of property alleged to be payable under Section 3475 of the Internal Revenue Code of 1939 as then in effect. The checks which Plaintiff gave the railroads in payment of the freight bills as aforesaid included the amount of the said transportation tax.

5) During the period July 7, 1950 to August 7,

1950, [9-B] the checks with which the aforesaid freight and tax were paid were drawn upon Plaintiff's bank account with the Farmers and Merchants National Bank of Los Angeles, Los Angeles, California, in the case of bills paid from Plaintiff's mill in Los Angeles; upon the Plaintiff's account with the Metropolitan Branch of the Seattle-First National Bank, Seattle, Washington, in the case of bills paid from Plaintiff's mill in Seattle; and upon the Bank of America National Trust and Savings Association, San Francisco, California, in payment of bills paid from Plaintiff's mill in Oakland, California.

6) On August 7, 1950 Plaintiff opened a bank account with the Canadian Bank of Commerce in Vancouver, British Columbia, Canada, and the checks with which the freight bills together with the transportation tax from then to October 31, 1950 were paid as aforesaid were drawn upon said account in Canada. Plaintiff's only purpose in opening said bank account in Canada with the Canadian Bank of Commerce and in subsequently drawing checks on that account in payment of charges for transportation of property between points in the United States was to save transportation taxes.

7) The amounts of federal transportation tax paid to each of the railroads by Mr. Grout in Canada with checks drawn upon Plaintiff's bank accounts in the United States, as aforesaid and with checks drawn upon Plaintiff's bank account with the Canadian Bank of Commerce, Vancouver, Brit-

ish Columbia, Canada, as aforesaid, and the total amounts of tax so paid, were respectively as follows:

Railroad and Head Office Address	Tax Paid From U.S. Accounts	Tax Paid From Canadian Account	Total Tax
Southern Pacific RR. 65 Market St., San Francisco 5, Calif.	$4,440.22	$11,749.35	$16,189.57
Union Pacific RR. 120 Broadway, New York 5, New York	570.24	2,376.06	2,946.30
Northern Pacific Ry. 176 E. 5th St., St. Paul 1, Minn.	746.76	3.303.84	4,050.60
Chicago, Milwaukee, St. Paul & Pacific RR. 516 W. Jackson Blvd., Chicago 6, Illinois	49.08	1,244.56	1,293.64
Spokane, Portland & Seattle Ry. 1101 N.W. Hoyt St., Portland 7, Oregon	229.07	857.72	1,086.79
Oregon Electric Ry. 1101 N.W. Hoyt St., Portland 7, Oregon	3.86	1.18	5.04
Pacific Motor Trucking Co., 65 Market St., San Francisco 5, Calif.	—0—	4.11	4.11
Great Northern Ry. 175 E. 4th St., St. Paul 1, Minn.	218.98	2.232.81	2,451.79
Totals	$6,258.21	$21,769.63	$28.027.84

All said checks issued by Plaintiff in payment for the transportation services with which this suit is concerned were deposited by the carriers in banks located within the United States.

8) On or before October 31, 1950, all of said

checks drawn upon the Canadian Bank of Commerce, as aforesaid, were, before delivery of them by Mr. Grout to the carriers, presented by Mr. Grout to the said Canadian Bank of Commerce for acceptance, and stamped accepted by said bank. All of said checks were actually collected by the railroads on or before October 31, 1950, with the exception of checks for an aggregate total of freight with respect to which $2,170 of transportation tax was paid. The latter checks were collected after October 31, 1950.

9) Both parties believe that said railroads paid [9-D] the entire sum collected by each as a tax as aforesaid to the Collector of Internal Revenue in their respective Collection Districts as required by law.

10) Neither the whole nor any part of said sums has been refunded to any of said railroads by the Defendant and no part of said sums has been repaid to Plaintiff by the respective railroads or by the Defendant, and Plaintiff has not consented to the allowance of credit or refund of any of said sums to the respective railroads.

11) The aforesaid D. L. Grout was first employed on September 8, 1947 as an Assistant Manager of the feed store operated by Plaintiff at Bellingham, Washington and was employed in this capacity at all times material herein.

12) On or about August 4, 1953, Plaintiff duly filed with the District Director of Internal Revenue, Los Angeles, California, a claim for refund for

the full amount of the aforesaid taxes plus interest alleging said taxes to have been illegally collected by the aforesaid railroads. The claim was for the sum of $29,299.35 plus interest as provided by law, but Plaintiff is here bringing suit for $28,027.84 of said taxes, plus interest, and waives recovery of the balance of $1,271.51 of said taxes. Said claim was disallowed in full by the District Director of Internal Revenue in Los Angeles by letter dated July 23, 1954.

13) Plaintiff is and always has been sole owner of the claim referred to herein and has not assigned or transferred the whole or any part thereof or any interest therein. [9-E]

Dated this 15th day of October, 1957, at Los Angeles, California.

JOHN H. MAYNARD,
ROBERT W. DRISCOLL,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff.
LAUGHLIN E. WATERS,
United States Attorney,
EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division,
JOHN G. MESSER,
Assistant U. S. Attorney,
/s/ By JOHN G. MESSER,
Attorneys for Defendant,
United States of America.

[Endorsed]: Filed October 16, 1957.

United States District Court, Southern District of California, Central Division

No. 20,216-PH Civil

[Title of Cause.]

MINUTES OF THE COURT

Date: October 22, 1957. At: Los Angeles, Calif.

Present: Hon. Peirson M. Hall, District Judge.

Deputy Clerk: S. W. Stacey. Reporter: Agnar Wahlberg. Counsel for Plaintiff: John H. Maynard, Esq. Counsel for Defendant: John G. Messer, Esq., Ass't. U. S. Attorney.

Proceedings: Trial: Both sides argue and stipulate as to certain facts, and It Is Ordered and Adjudged that judgment be for the defendant and that defendant attorney prepare findings, conclusions of law and judgment.

JOHN A. CHILDRESS,
Clerk,

/s/ By S. W. STACEY,
Deputy Clerk.

(PH 10/22/57) [9-G]

United States District Court, Southern District of California, Central Division

No. 20216-PH Civil

ALBERS MILLING COMPANY, a Corporation,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This cause came on for trial on October 22, 1957, before the Honorable Peirson M. Hall, Judge, presiding, without the intervention of a jury. Plaintiff was represented by its counsel John H. Maynard and William H. Birnie, and the defendant was represented by its counsel, Laughlin E. Waters, United States Attorney, Southern District of California, Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and John G. Messer, Assistant United States Attorney. The Court, having heard and considered all the evidence, stipulation of facts and briefs and argument of counsel, makes the following findings of fact and conclusions of law:

Findings of Fact

I.

Plaintiff, Albers Milling Company, at all times herein mentioned was, and now is, a corporation

duly organized and existing under the laws of the State of Oregon. [10]

II.

Plaintiff is qualified to do business in the State of California and has its general offices and principal place of business in the City of Los Angeles, County of Los Angeles, California.

III.

During the period from July 7, 1950 to October 31, 1950 the plaintiff shipped various quantities of its goods and merchandise between various points in the United States over the lines of Southern Pacific Railroad, Union Pacific Railroad, Northern Pacific Railway, Chicago, Milwaukee, St. Paul & Pacific Railroad, Spokane, Portland & Seattle Railway, Oregon Electric Railway, Pacific Motor Trucking Company and Great Northern Railway. All such shipments originated and terminated within the United States. These railroads, including Pacific Motor Trucking Company, sent their bills for freight for the aforesaid shipments to the plaintiff at its offices in the United States. These bills, together with the checks of the plaintiff in payment thereof, were mailed by the plaintiff to the office of Carnation Company Limited, an affiliated Company, in Vancouver, British Columbia, Dominion of Canada. A full-time bona fide employee of one of plaintiff's feed stores, Mr. D. L. Grout, traveled twice each week from Bellingham, Washington, to Vancouver, British Columbia, picked up the freight

bills and the checks for the payment thereof at the office of Carnation Company, Limited and presented them to the agents of the aforesaid carriers in Vancouver, who accepted the checks in payment and recorded the bills as paid.

IV.

Plaintiff's only purpose in mailing its checks in payment of said bills to its Canadian affiliated company and in having Mr. Grout travel from Bellingham, Washington, to Vancouver, British Columbia, and to deliver said checks in payment of the freight bills to Canadian agents of said carriers in Canada was to save transportation taxes. [11]

V.

The carriers also added to the amounts of their freight bills and demanded from plaintiff payment of the federal tax upon the transportation of property under the provisions of Section 3475 of the Internal Revenue Code of 1939 during the period herein involved.

VI.

During the period July 7, 1950 to August 7, 1950, the checks with which the aforesaid freight and tax were paid were drawn upon plaintiff's bank account with the Farmers and Merchants National Bank of Los Angeles, Los Angeles, California, in the case of bills paid from plaintiff's mill in Los Angeles; upon the plaintiff's account with the Metropolitan Branch of the Seattle-First National Bank, Seattle, Washington, in the case of bills paid

from plaintiff's mill in Seattle, and upon the Bank of America National Trust and Savings Association, San Francisco, California, in payment of bills paid from plaintiff's mill in Oakland, California.

VII.

On August 7, 1950 plaintiff opened a bank account with the Canadian Bank of Commerce in Vancouver, British Columbia, Canada, and the checks with which the freight bills together with the transportation tax from then to October 31, 1950 were paid as aforesaid were drawn upon said account in Canada.

VIII.

Plaintiff's only purpose in opening said bank account in Canada with the Canadian Bank of Commerce and in subsequently drawing its checks on that account in payment of charges for transportation of property between points within the United States, together with taxes on said transportation, was to save transportation taxes.

IX.

The amounts of federal transportation tax paid to each of [12] the railroads by Mr. Grout in Canada with checks drawn upon plaintiff's bank accounts in the United States, as aforesaid and with checks drawn upon plaintiff's bank account with the Canadian Bank of Commerce, Vancouver, British Columbia, Canada, as aforesaid, and the total amounts of tax so paid, were respectively as follows:

Railroad and Head Office Address	Tax Paid From U.S. Accounts	Tax Paid From Canadian Account	Total Tax
Southern Pacific RR. 65 Market St., San Francisco 5, Calif.	$4,440.22	$11,749.35	$16,189.57
Union Pacific RR. 120 Broadway, New York 5, New York	570.24	2,376.06	2,946.30
Northern Pacific Ry. 176 E. 5th St., St. Paul 1, Minn.	746.76	3,303.84	4,050.60
Chicago, Milwaukee, St. Paul & Pacific RR. 516 W. Jackson Blvd., Chicago 6, Illinois	49.08	1,244.56	1,293.64
Spokane, Portland & Seattle Ry. 1101 N.W. Hoyt St., Portland 7, Oregon	229.07	857.72	1,086.79
Oregon Electric Ry. 1101 N.W. Hoyt St., Portland 7, Oregon	3.86	1.18	5.04
Pacific Motor Trucking Co., 65 Market St., San Francisco 5, Calif.	—0—	4.11	4.11
Great Northern Ry. 175 E. 4th St., St. Paul 1, Minn.	218.98	2.232.81	2,451.79
Totals	$6,258.21	$21,769.63	$28,027.84

X.

All checks issued by plaintiff in payment for the transportation services involved in this action were deposited by the carriers in banks located within the United States.

XI.

On or before October 31, 1950, all of said checks drawn on the Canadian Bank of Commerce, as set forth above, before delivery of them by Mr. Grout

to the carriers were presented by Mr. Grout to the said Canadian Bank of Commerce for acceptance, and stamped accepted by the bank. All of said checks were collected by the carriers on or before October 31, 1950, with the exception of checks for an aggregate total of freight with respect to which $2,170.00 of transportation tax was paid. The latter checks were collected after October 31, 1950.

XII.

No part of the taxes herein involved has been refunded to any of the said carriers by the defendant, and no part of said taxes has been repaid to plaintiff by the said carriers or by the defendant. Plaintiff has not consented to the allowance of credit or refund of any of said taxes to the said carriers.

XIII.

The aforementioned Mr. Grout was first employed on September 8, 1947, as an assistant manager of the feed store operated by plaintiff at Bellingham, Washington, and was employed in that capacity during the period herein involved.

XIV.

On or about August 4, 1953, plaintiff duly filed a claim for refund of the taxes herein involved in the amount of $29,299.35, but waived $1,271.51 of said amount and filed this action for $28,027.84 of said taxes. Said claim for refund was rejected by letter dated July 23, 1954. This action was filed on July 18, 1956. [14]

XV.

All conclusions of law which are or are deemed to be findings of fact are hereby found as facts and incorporated herein as findings of fact.

Conclusions of Law

I.

The Court has jurisdiction of the subject matter and of the parties hereto under the provisions of Title 28, U.S.C., Section 1346(a)(1).

II.

Plaintiff has not sustained its burden of proving that the taxes paid on the transportation of property were not subject to the tax imposed under the provisions of Section 3475 of the Internal Revenue Code of 1939 for the period herein involved.

III.

The transportation taxes imposed by Section 3475 of the Internal Revenue Code of 1939 were legally imposed and collected from the plaintiff. Plaintiff was required by Section 3475(a) of the Internal Revenue Code of 1939 to pay transportation taxes on shipments of property which were made entirely within the United States, and is not entitled to any refund of said taxes for the period involved herein. Defendant is entitled to judgment dismissing the complaint herein together with its costs.

IV.

All findings of fact which are deemed to be conclusions of law are hereby incorporated in these conclusions of law.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, it is hereby ordered, adjudged and decreed:

That the plaintiff take nothing by its complaint; that the above-entitled action be dismissed with prejudice; and that the defendant have judgment for and shall recover from plaintiff [15] the amount of defendant's costs, to be taxed by the Clerk of this Court in the sum of $20.00.

Dated: This 7th day of November, 1957.

/s/ PEIRSON M. HALL,
United States District Judge.

Affidavit of Service by Mail Attached. [17]

[Endorsed]: Filed and Entered November 7, 1957.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO COURT OF APPEALS UNDER RULE 73(b)

Notice is hereby given that Albers Milling Company, Plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on November 7, 1957.

Dated: This 31st day of December, 1957.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff. [18]

[Endorsed]: Filed January 2, 1958.

[Title of District Court and Cause.]

APPELLANT'S DESIGNATION OF CONTENTS OF RECORD ON APPEAL

Appellant, Albers Milling Company, hereby designates the following portions of the record, proceedings and evidence to be contained in the record on appeal to the United States Court of Appeals for the Ninth Circuit, in this action:

(1) Plaintiff's Complaint.

(2) Defendant's Answer.

(3) The Findings of Fact, Conclusions of Law, and Judgment of the District Court dated and filed November 7, 1957.

(4) Plaintiff's Notice of Appeal filed January 2, 1958.

(5) This designation of contents of the record to be contained in the record on appeal.

(6) The Statement of Points Upon Which the Appellant Intends to Rely Upon Appeal.

Dated this 15th day of January, 1958.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff-Appellant. [19]

Affidavit of Service by Mail Attached. [20]

[Endorsed]: Filed January 15, 1958.

[Title of District Court and Cause.]

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY ON APPEAL

Appellant intends to rely upon the following points upon appeal to the United States Court of Appeals for the Ninth Circuit in this action:

(1) The District Court erred in holding that Appellant did not sustain the burden of proof that the taxes in question were not payable under Section 3475 of the Internal Revenue Code of 1939 for the period in question. The circumstances under which payment was made, as set forth in the Findings of Fact, establish that the taxes in question were improperly levied and collected and should be refunded.

(2) The District Court erred in holding that the taxes in question were legally imposed and collected from Plaintiff under Section 3475(a) of the Internal Revenue Code of 1939. This section does not tax freight charges upon the transportation of property during the period involved where payment of such charges was made outside the United States as set forth in the Findings of Fact. [21]

(3) The District Court erred in that the conclusions of law are not supported by the Findings of Fact.

(4) The District Court erred in holding that Appellant was not entitled to refund of the $28,027.84 of federal transportation taxes paid, plus interest, and that the action should be dismissed.

(5) In the alternative, the District Court erred

in holding that Appellant was not entitled, in any event, to refund of the $21,769.63 of taxes paid, plus interest. These taxes and the freight charges upon which they were levied were paid in Canada with checks drawn upon Appellant's account with the Canadian Bank of Commerce, Vancouver, British Columbia, Canada, as set forth in the Findings of Fact.

Dated this 15th day of January, 1958.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff-Appellant. [22]

Affidavit of Service by Mail Attached. [23]

[Endorsed]: Filed January 15, 1958.

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 23, inclusive, containing the original:

Complaint.

Answer.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Appeal.

Designation of Contents of Record on Appeal.

Statement of Points upon which Appellant intends to rely on Appeal.

I further certify that my fee for preparing the foregoing record, amounting to $1.60, has been paid by appellant.

Dated: January 25, 1958.

[Seal] JOHN A. CHILDRESS,
Clerk,
/s/ By WM. A. WHITE,
Deputy Clerk. [24]

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the supplemental transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 9, inclusive, containing the original:

Stipulation of Facts.

Minute Order of Oct. 22, 1957.

Defendant's Additional Designation of Record on Appeal.

Dated: January 27, 1958.

[Seal] JOHN A. CHILDRESS,
Clerk,
/s/ By WM. A. WHITE,
Deputy Clerk. [27]

[Endorsed]: No. 15869. United States Court of Appeals for the Ninth Circuit. Albers Milling Company, a corporation, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: January 25, 1958.

Docketed: February 3, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15869

ALBERS MILLING COMPANY, a Corporation,
Plaintiff-Appellant,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellee.

STATEMENT OF POINTS AND DESIGNATION OF RECORD UPON APPEAL

Appellant, Albers Milling Company, upon appeal in the above cause from the judgment entered November 7, 1957 of the District Court of the United States, Southern District of California,

Central Division, Honorable Peirson M. Hall, Judge, presiding, hereby adopts the Statement of Points Upon Which Appellant Intends to Rely on Appeal, dated and filed January 15, 1958 in the District Court, and Appellant's Designation of Contents of Record on Appeal, dated and filed January 15, 1958 in the District Court, as its statement of points and designation of the record which is material to the consideration of the appeal under Rule 17 (6) of the United States Court of Appeals for the Ninth Circuit.

Dated this 3rd day of February, 1958.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
/s/ By JOHN H. MAYNARD,
Attorneys for Plaintiff-Appellant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed February 4, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

APPELLEE'S COUNTER DESIGNATION OF RECORD NECESSARY FOR CONSIDERATION ON APPEAL AND TO BE PRINTED

Pursuant to Rule 17(6) of this Court, appellee in the above-entitled proceedings hereby additionally designates the following parts of the record as being necessary for consideration of the appeal and desires to have printed, omitting the title of Court and cause from the documents designated for printing:

1. Stipulation of Facts filed October 16, 1957;
2. Minutes of the Court of October 22, 1957.

Dated: February 10, 1958.

LAUGHLIN E. WATERS,
United States Attorney,
EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division,
JOHN G. MESSER,
Assistant U. S. Attorney,
/s/ JOHN G. MESSER,
Attorneys for United States of America.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed February 11, 1958. Paul P. O'Brien, Clerk.

No. 15869

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERS MILLING COMPANY, a Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
5045 Wilshire Boulevard,
Los Angeles 36, California,
Attorneys for Appellant.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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No. 15869

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERS MILLING COMPANY, a Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

Jurisdiction.

Appellant, Albers Milling Company, at all times pertinent herein was and is now a corporation duly organized and existing under the laws of the State of Oregon and qualified to do business in the State of California with its general offices and principal place of business located in the City of Los Angeles, County of Los Angeles, State of California. [R. 3, 18, 19.]

This appeal involves the federal excise tax upon the transportation of property. The taxes in dispute were paid by Appellant upon freight charges incurred for the transportation of its goods and merchandise from one point within the United States to another by common carriers. These taxes were collected by the carriers and paid to the Collectors of Internal Revenue in their respective collection districts. [R. 5, 19, 15.]

This proceeding involves claim for refund of transportation taxes, paid as aforesaid, in the amount of $28,027.84 for the period July 7, 1950 to October 31, 1950, plus interest thereon as allowed by law. [R. 7, 23.]

Proper claim for refund of said taxes, plus interest, was timely filed by Appellant with the District Director of Internal Revenue in Los Angeles, California. Said claim was disallowed in full. Thereafter suit thereon was duly filed in the District Court below. [R. 6, 23.] Jurisdiction was conferred upon that Court by Title 28, U. S. C., Section 1346(a)(1). [R. 24.] Final judgment was entered against Appellant by the District Court on November 7, 1957, and notice of appeal was timely filed on January 2, 1958. [R. 25.] Jurisdiction is conferred on this court by Title 28, U. S. C., Sections 1291, 1294.

Question Presented.

Can the federal tax upon the transportation of property be imposed for the period in question under Section 3475 (a) of the Internal Revenue Code of 1939, as amended, upon freight charges for merchandise transported within the United States where payment of the freight is made outside the United States by a bona fide employee of the taxpayer?

Statement of the Case.

During the period from July 7, 1950 to October 31, 1950, Appellant shipped quantities of its merchandise between various points in the United States over the lines of various railroads. These carriers billed Appellant for

the freight charges thus incurred plus the 3% federal transportation tax alleged to be payable thereon under Section 3475 of the Internal Revenue Code of 1939, as then in effect. [R. 19, 20.]

Appellant paid these freight bills, together with the transportation tax claimed by the carriers, with checks drawn upon various of its bank accounts. The checks, together with the associated freight bills, were mailed by Appellant to the Canadian office of one of its affiliated companies in Vancouver, British Columbia, Canada. Mr. D. L. Grout, a bona fide full-time employee of one of Appellant's feed stores in the State of Washington, traveled twice weekly to Vancouver, Canada, picked up the freight bills and the checks at the Canadian office and presented them in person to the agents of the respective carriers in Vancouver. The agents accepted the checks in payment and recorded the freight bills as paid. [R. 19, 20.]

The checks with which these bills were paid prior to August 7, 1950, were drawn upon various bank accounts maintained by appellant in banks in the United States. On August 7, 1950, appellant opened a bank account with the Canadian Bank of Commerce in Vancouver, Canada, and thereafter payment of the freight bills in Canada was made with checks drawn upon this account. [R. 21.] Before delivering these checks to the carriers Mr. Grout presented them to the Canadian Bank of Commerce, the bank upon which they were drawn, for acceptance. The bank thereupon accepted each of them and stamped each "Accepted". After these checks were thus accepted by

the Canadian bank Mr. Grout delivered them to the agents of the carriers in payment of the freight bills as previously indicated. [R. 20, 23.]

The amount of tax paid with checks drawn on the bank accounts in the United States was $6,258.21, and the amount of the tax paid with checks drawn on the Canadian account was $21,769.63, making total taxes of $28,027.84. [R. 22.]

Thereafter Appellant duly filed claim for refund of these taxes with the Director of Internal Revenue. [R. 23.] Recovery thereon was denied by the Director of Internal Revenue and by the District Court below following suit thereon. [R. 23, 25.] This appeal followed. [R. 25.]

Specification of Errors.

1. The District Court erred in holding that the transportation tax was payable upon charges for transportation of property where these charges were not paid within the United States. The court erroneously disregarded its own findings of fact regarding payment of the freight bills in Canada. [R. 24.]

2. The District Court erred in its interpretation of the taxing statute, in that the statute did not make imposition of the tax depend only upon shipment of the property being wholly within the United States. Payment of the freight charges within the United States was another statutory requirement for imposition of the tax. [R. 24.]

ARGUMENT.

I.

Under the Plain Meaning of the Taxing Statute the Transportation in Question Is Not Taxable and This Meaning Should Be Given Effect.

Section 3475(a) of the Internal Revenue Code of 1939 as amended (26 U. S. C., Sec. 3475), as in effect prior to November 1, 1950 and during the period July 7, 1950 to October 31, 1950, here in question, by its express terms levied the tax only upon amounts "paid within the United States". Briefly stated, this is an excise tax upon amounts paid under the following conditions: (1) paid within the United States, and (2) paid for the transportation of property by common carrier from one point in the United States to another.

The pertinent portions of said Section 3475(a) are as follows:

> "(a) Tax.—There shall be imposed upon the amount *paid within the United States* after the effective date of this section for the transportation, on or after such effective date, of property by rail, motor vehicle, water, or air from one point in the United States to another, a tax equal to 3 per centum of the amount so paid, . . ." (Emphasis supplied.)

Since these amounts were not paid within the United States, but were paid by Mr. Grout in Canada, the tax cannot apply. Congress could have made the tax payable even where the transportation charges were paid outside the United States but it did not choose to do so.

Later Congress decided that the tax should also apply where the payment was made outside the United States and promptly amended the law to so provide. Section 607(b), (c) of the Revenue Act of 1950, approved September 23, 1950, amended Section 3475(a) of the Internal Revenue Code of 1939 as follows:

> "(b) *Transportation of Property*—The first sentence of Section 3475(a) (relating to tax on transportation of property) is hereby amended to read as follows:
>
> "There shall be imposed upon the amount *paid within or without the United States* for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another, a tax equal to 3 per centum of the amount so paid, . . ." (Emphasis supplied.)
>
> "(c) *Effective date.*—The amendments made by this section shall apply to amounts paid on or after the first day of the first month which begins more than ten days after the date of the enactment of this Act for transportation which begins on or after such first day."

The amendment specifically provides that it shall apply only to payments made after the effective date thereof, which was November 1, 1950. The Commissioner of Internal Revenue also recognized that the amendment applied prospectively only by amending Regulations 113, Section 143.11, pertaining to this tax, to read as follows:

> "Sec. 143.11 Scope of Tax.—Section 3475(a) imposes a tax upon (a) amounts *paid within the United States* after December 1, 1942, for transportation, originating on or after such date, of property by rail,

motor vehicle, water, or air from one point in the United States to another, and (b) *amounts paid without the United States, on or after November 1, 1950,* for transportation, originating on or after such date, of property by rail, motor vehicle, water, or air from one point in the United States to another. The tax applies only to amounts paid to a person engaged in the business of transporting property for hire." (Emphasis supplied.) (See T. D. 5826, 1951-1 Cum. Bul. 148.)

And again in Section 143.13 of the same Regulations the following paragraph was included:

"With respect to amounts paid without the United States, the tax applies to amounts paid on or after November 1, 1950, for transportation originating on or after that date."

II.

The Transportation Charges Were "Paid" in Canada Within the Meaning of the Taxing Statute.

Appellant maintains that the amount of freight and the taxes in question were not paid within the United States. It paid such amounts outside the United States and within Canada. When Appellant's employee handed the checks to the carriers and they accepted them in Canada, the bills were paid.

To pay, in ordinary and common usage, includes to give a check in payment of a purchase or obligation. So common is the use of checks for payment of obligations today, that the whole business community would be surprised at any suggestion that the giving and receipt of a check did not constitute payment.

The universality of this usage is indicated by the definition of "pay" in Webster's New International Dictionary, 2d Edition Unabridged, as including:

> "To give a recompense; to make payment, requital or satisfaction; to discharge a debt; as he *pays* in full, *by check or on time.*" (Last emphasis supplied.)

The common meaning of payment as embracing the giving and receipt of a check is indicated in this language from *Miller v. Commissioner,* 164 F. 2d 268 (C. C. A. 3, 1947):

> "Furthermore, as a matter of common parlance, we think it is most common to speak of 'paying' an obligation by giving one's check for it. This is the common method of paying bills in this country."

The Court of Claims in *Kellogg Company v. United States,* 133 Ct. Cl. 507, 133 Fed. Supp. 387 (1955), cert. den., 350 U. S. 903, 100 L. Ed. 793, which is more fully discussed below, seems to have questioned whether delivery to the creditor in Canada of a cashier's check drawn upon a United States Bank constitutes payment in Canada rather than in the United States.

While Appellant firmly believes that the Court's decision was erroneous, in that delivery of a good check itself constitutes payment of the debt, Appellant's case is substantially distinguishable on the facts from the *Kellogg* case. $21,769.63 of the tax here in dispute, and the freight charges upon which the tax was levied, were paid with checks drawn upon Appellant's account with the Canadian Bank of Commerce in Vancouver, rather than with checks drawn upon a bank in the United States as in the case of the Kellogg Company.

The Court of Claims pointed out at 133 Fed. Supp. 389, that the cashier's checks with which the bills were paid were issued within the United States; drawn on a bank within the United States; and endorsed to the transportation companies within the United States. It observed that the checks were no doubt deposited and came back to the issuing bank for final payment. The Court then suggested that delivery of the checks to the carriers was merely a conditional payment until the checks were finally honored and paid by the issuing bank.

If "payment" of a debt, where made by check, is deemed to take place where the check is honored and paid by the bank upon which it is drawn, as indicated by the Court of Claims, payment in Appellant's case clearly took place in Canada with respect to checks drawn on the Canadian account. These checks were accepted by the drawee bank before they were given to the transportation companies and were later paid by the drawee bank in Canada. Payment took place without, not within, the United States.

Indeed, one of the three Judges in the majority in *Kellogg v. United States, supra,* based his decision entirely upon the proposition that the charges were "paid" within the United States. It would seem that under these circumstances even the Court of Claims would have held for Appellant herein through a change in the position of at least this one Judge, if this case had been before that Court.

Furthermore these checks were "accepted" by the Canadian bank before they were delivered to the carriers, thus earmarking from Appellant's account funds for payment of the check upon final presentation by the payee. Under such circumstances handing the "accepted" checks

to the railroads was virtually equivalent to a cash payment.

Under Canadian law acceptance of the check has the effect of giving it additional currency by showing on the face that it is drawn in good faith on funds sufficient to meet its payment and by adding to the credit of the drawer that of the drawee bank. See *Gaden v. The Newfoundland Savings Bank,* 12 A. C. 128, 134 (1899); Bills of Exchange Act, R. S., C. 16, Secs. 127, 128.

III.

The Scope of the Tax Statutes Should Not Be Extended by "Judicial Legislation".

Appellant further notes *Kellogg Company v. United States, supra,* in which a bare majority of three to two denied refund of transportation tax paid in Canada. Appellant maintains that its case is distinguishable on the facts from *Kellogg Company v. United States, supra,* because of the means of payment, as previously indicated, and further maintains that the *Kellogg* case is erroneously decided as a matter of law, is not binding upon this Court, and should be disregarded as a precedent.

Some of the Justices on the Court of Claims seem to have fallen into the error of disregarding the clear cut, objective test of taxability based upon place of payment, as prescribed by Congress in Section 3475(a), in favor of a subjective test based upon the taxpayer's motives for selecting one place of payment in preference to another.

While it is true that nebulous theories based upon questions of motive, intent, business purpose and the like have been introduced into the field of income taxation by administrative interpretation supported by some court

decisions, these theories should have no place in the precise field of excise taxation. An excise tax is a tax levied upon a particular thing or act. Precisely what Congress says is taxable should be taxed, and what it does not specifically tax should not be taxable. The purpose or motive of the taxpayer in placing his transaction within or without the reach of the tax then becomes irrelevant. It has thus been recognized in many excise tax cases that a taxpayer may so order his business as to pay the minimum tax which the law requires.

In *Samson Tire and Rubber Corporation v. Rogan,* 136 F. 2d 345, 347 (C. C. A. 9, 1943), the taxpayer had entered into a written contract with an affiliated company for the sale of tires and tubes as of June 1, 1932 in order to avoid the excise tax which became effective upon sales on and after June 21, 1932. The tires and tubes in question were not delivered to the buyer until after June 21, 1932. The Court of Appeals for the Ninth Circuit noted that one purpose of the agreement was to avoid the excise tax, but held for the taxpayer and quoted from *Gregory v. Helvering,* 293 U. S. 465, 469, 79 L. Ed. 596 as follows:

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

In *Standard Oil Company v. United States,* 130 Fed. Supp. 821, 823 (1955), the Court of Claims, the court which decided the *Kellogg* Case, *supra,* had before it the question whether the "sale" of gasoline from taxpayer to its wholly owned subsidiary on June 27, 28, 29 and 30,

1940, was sufficient to avoid increase in the federal manufacturer's sales tax on gasoline, which became effective July 1, 1940. Ordinarily the taxpayer held the gasoline itself until it was ready to sell it, but by selling it to the subsidiary before the effective date of the increase the higher rates were avoided. Since the subsidiary was not a manufacturer the subsequent sale by it after the tax went into effect would not be taxable. The Court held for the taxpayer and reasoned in part as follows:

> "We think that what occurred in the case before us was tax avoidance, and not tax evasion. The fact that there was no reason for the parties doing what they did, when they did it, except to escape taxes, does not make the transaction vulnerable. *United States v. Cumberland Public Service Co.,* 338 U. S. 451, 70 S. Ct. 280, 94 L. Ed. 251, affirming 83 F. Supp. 843, 113 Ct. Cl. 460."

This has been the rule at least as far back as 1873 in which the Supreme Court in *United States v. Isham,* 17 Wall. 496, 21 L. Ed. 728, 731, made the following analysis:

> "It is said that the transaction proved upon the trial in this case, is a device to avoid the payment of a stamp duty, and that its operation is that of a fraud upon the revenue. This may be true, and if not true in fact in this case, it may well be true in other instances. To this objection there are two answers:
>
> "1. That if the device is carried out by the means of legal forms, it is subject to no legal censure. To illustrate: The stamp act of 1862 imposed a duty of two cents upon a bank check, when drawn for an amount not less than $20. A careful individual, having the amount of $20 to pay, pays the

same by handing to his creditor two checks for $10 each. He thus draws checks in payment of his debts to the amount of $20, and yet pays no stamp duty. This practice and this system he pursues habitually and persistently. While his operations deprive the government of the duties it might reasonably expect to receive, it is not perceived that the practice is open to the charge of fraud. He resorts to devices to avoid the payment of duties, but they are not illegal. He has the legal right to split up his evidences of payment and thus to avoid the tax. The device we are considering is of the same nature."

The difficulties created in extending by judicial interpretation the scope of a statute beyond its plain meaning are shown in the cases which decide whether a particular instrument is subject to tax upon issue as a debenture or similar security, or non-taxable as a promissory note. In *United States v. Leslie Salt Company,* 218 F. 2d 91, 92-93 (C. A. 9, 1954), affirmed 350 U. S. 383, 100 L. Ed. 441, the Court of Appeals held that an instrument issued by a bank and denominated a promissory note was non-taxable although it had many of the characteristics of instruments which some courts had deemed taxable. The court said:

"We are not prepared to say that the decision [of the lower court] is wrong. There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with

the development. Congress has since had abundant opportunity to legislate on the subject but has not seen fit to do so. We can not but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress.

"In going one way or the other the judges have frequently relied on distinctions which appear to us to be without difference, mainly on whether the loan was negotiated with an insurance company or whether it was negotiated with a commercial bank. We may add that subsequent to the opinion below several decisions have come down, heading, as was inevitable, in all directions. The chief of these more recent efforts is the Second Circuit case of *Niles-Bement-Pond Co. v. Fitzpatrick,* 213 F. 2d 305. There the court, in holding for the taxpayer, wrestled with the unpleasant if not impossible task of distinguishing an earlier opinion of its own. Fortunately we are confronted with no problem of that nature."

Similar difficulties can result if the courts are required to decide under what circumstance handing a check to a creditor outside the United States is payment outside the United States and under what circumstances the very same act is payment "within" the United States.

And in *Crooks v. Harrelson,* 282 U. S. 55, 61, 75 L. Ed. 156, 176 (1930), in deciding a question of construction regarding the federal estate tax, a type of excise tax, the Court states:

"In support of the claim that a literal construction is not admissible, it is said that by other provisions of Sec. 402 certain interest in real property, such as dower, etc., are made subject to the tax without

regard to the conditions set forth in subdivision (a), and that this results in an incongruity amounting to an absurdity. But unless the Constitution be violated, Congress may select the subjects of taxation and qualify them differently as it sees fit; and if it does so in plain terms, as it has done here, it is not within the province of the court to modify the law by construction. In any event, conceding that the conditions assailed have produced the incongruous results complained of, they fall far short of that degree of absurdity contemplated by *Church of the Holy Trinity v. United States,* 143 U. S. 457, 36 L. Ed. 226, 12 S. Ct. 511, or by any other decision of this court.

"Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness. In *United States v. Merriam,* 263 U. S. 179, 187, 188, 68 L. Ed. 240, 244, 29 A.L.R. 1547, 44 S. Ct. 69, after saying that 'in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used,' we quoted with approval the words of *Lord Cairns in Partington v. Atty. Gen.,* L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however, apparently, within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

IV.
Conclusion.

Appellant should be taxed in accordance with the manner in which it actually transacted its business. The statute said that amounts paid within the United States for transportation were taxable. No rational basis existed for taxing amounts paid outside the United States until Congress decided to amend the law effective November 1, 1950. The government should not expect the courts to give retroactive effect to this amendment where Congress itself did not so do.

Wherefore, Appellant prays that the judgment below be reversed.

JOHN H. MAYNARD,
WILLIAM H. BIRNIE,
Attorneys for Appellant.

No. 15869

In the United States Court of Appeals for the Ninth Circuit

ALBERS MILLING COMPANY, A CORPORATION, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

BRIEF FOR THE APPELLEE

CHARLES K. RICE,
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In the United States Court of Appeals for the Ninth Circuit

No. 15869

ALBERS MILLING COMPANY, A CORPORATION, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

---

BRIEF FOR THE APPELLEE

OPINION BELOW

The findings of fact and conclusions of law of the District Court (R. 18-24) are not officially reported.

JURISDICTION

This appeal involves federal transportation taxes for the period July 7, 1950, to October 31, 1950, during which period the taxes in dispute in the amount of $28,027.84 were paid. (R. 21-23.) Claim for refund was filed on August 4, 1953, and was rejected on July 23, 1954. (R. 23.) Within the time pro-

vided in Section 3772 of the Internal Revenue Code of 1939, and on July 18, 1956, the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 1-7, 23.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment was entered on November 7, 1957. (R. 25.) Within sixty days and on January 2, 1958, a notice of appeal was filed. (R. 25.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether taxpayer is not required by Section 3475 (a) of the Internal Revenue Code of 1939 to pay transportation taxes on shipments of property which were made entirely within the United States solely because the freight charges were paid for by checks, drawn on a United States bank and a Canadian bank, which were mailed to Canada and manually delivered to the offices of the carriers located outside the United States and where the sole purpose of this method was to avoid the transportation tax.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 3475 [As added by Sec. 620(a), Revenue Act of 1942, c. 619, 56 Stat. 798]. TRANSPORTATION OF PROPERTY.
>
> (a) *Tax.*—There shall be imposed upon the amount paid within the United States after the effective date of this section for the transportation, on or after such effective date, of property by rail, motor vehicle, water, or air from one

point in the United States to another, a tax equal to 3 per centum of the amount so paid, except that, in the case of coal, the rate of tax shall be 4 cents per short ton. Such tax shall apply only to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to which a tax has previously been paid under this section. In the case of property transported from a point without the United States to a point within the United States, for that part of the transportation which takes place within the United States. The tax on the transportation of coal shall not apply to the transportation of coal with respect to which there has been a previous taxable transportation.

* * * *

(26 U.S.C. 1952 ed., Sec. 3475.)

STATEMENT

This case was tried upon the pleadings (R. 1-10) and a written stipulation of facts (R. 11-16). There is no controversy about the facts which are as follows:

The taxpayer, Albers Milling Company, is an Oregon corporation which has its general offices and principal place of business in Los Angeles, California. (R. 18-19.)

During the period from July 7, 1950, to October 31, 1950, taxpayer shipped various quantities of its goods and merchandise between various points in the United States over the lines of various railroads and by mo-

tor carrier.[1] All such shipments originated and terminated within the United States. The carriers sent their bills for freight for the shipments to taxpayer at its offices in the United States. (R. 19.)

The bills, together with taxpayer's checks in payment thereof, including the amount of the tax payable under Section 3475, were mailed by taxpayer to the office of an affiliated company in Vancouver, British Columbia. Mr. D. L. Grout, an employee of taxpayer, traveled twice each week from Bellingham, Washington, to Vancouver, British Columbia, picked up the freight bills and the checks for the payment thereof at the office of the affiliated company and presented them to the agents of the carriers in Vancouver, who accepted the checks in payment and recorded the bills as paid. (R. 19-20.)

Taxpayer's only purpose in mailing checks in payment of the freight bills to its Canadian affiliated company and in having Mr. Grout travel from Bellingham, Washington, to Vancouver, British Columbia, and to deliver the checks in payment of the freight bills to Canadian agents of the carriers in Canada was to save transportation taxes. (R. 20.)

During the period July 7, 1950, to August 7, 1950, the checks with which the freight and tax were paid were drawn upon taxpayer's accounts with banks in

---

[1] These lines, all hereafter referred to as carriers, were the Southern Pacific Railroad, Union Pacific Railroad, Northern Pacific Railway, Chicago, Milwaukee, St. Paul & Pacific Railroad, Spokane, Portland & Seattle Railway, Oregon Electric Railway, Pacific Motor Trucking Company and Great Northern Railway. (R. 19.)

the United States. On August 7, 1950, taxpayer opened a bank account with the Canadian Bank of Commerce in Vancouver, British Columbia, and the checks, with which the freight bills and tax from then to October 31, 1950, were paid were drawn upon this account in Canada. Taxpayer's only purpose in opening the bank account in Canada and in subsequently drawing checks on that account in payment of charges for transportation of property between points within the United States was to save transportation taxes. (R. 20-21.)

The taxes paid by checks drawn on banks in the United States, $6,258.21, and the taxes paid by checks drawn on the Canadian bank, $21,769.63, totaled $28,027.84. (R. 21-22.) All the checks issued by taxpayer in payment for the transportation services with which this suit is concerned were deposited by the carriers in banks located within the United States. (R. 22.)

On or before October 31, 1950, all of the checks drawn upon the Canadian bank were, before delivery of them by Mr. Grout to the carriers, presented by Mr. Grout to the Canadian bank for acceptance, and stamped accepted by the bank. (R. 22-23.)

On these facts, the District Court concluded that the transportation tax imposed by Section 3475 was properly due and collectible. (R. 24.)

The taxpayer filed claim for refund for these taxes paid, and the claim was disallowed. (R. 23.) Thereupon this action for refund was commenced, and judgment entered in favor of the United States. (R. 25.) From such judgment the taxpayer here appeals. (R. 25.)

SUMMARY OF ARGUMENT

The issue in the present case is identical and the basic facts are essentially the same as those considered by the Court of Claims in *Kellogg Co.* v. *United States*, and those in *Fisher Flouring Mills* v. *United States*, No. 15819, presently pending in this Court. For reasons more fully developed in our brief in the *Fisher Flouring Mills* case, the decision of the District Court is correct and should be affirmed.

ARGUMENT

Taxpayer Is Required By Section 3475(a) of the Internal Revenue Code of 1939 To Pay Transportation Taxes On Shipments of Property Which Were Made Entirely Within the United States, Payments for Which Were Purportedly Made By Unusual Methods Across the Border In Canada for the Sole Purpose of Avoiding These Taxes

The case at bar presents a factual pattern almost identical to that in *Kellogg Co.* v. *United States*, 133 F. Supp. 387 (C. Cls.), certiorari denied, 350 U.S. 903, and likewise almost identical to that in *Fisher Flouring Mills* v. *United States*, No. 15819, presently pending before this Court.[2] In our brief in the *Fisher Flouring Mills* case we have discussed at length the *Kellogg* decision and have pointed out why that decision correctly interpreted the provisions of Section

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[2] Another case docketed in this Court, *Pacific-Gamble Robinson Co.* v. *United States*, No. 15818, also presents the same factual pattern. A stipulation to hold further proceedings in abeyance until after the decisions in *Fisher* and in this case have been entered was filed on or about April 19, 1958, in *Pacific-Gamble*.

3475(a), *supra*, of the Internal Revenue Code of 1939. For the same reasons therein set forth, the judgment of the District Court in this case should be affirmed.[3]

As in *Kellogg* and *Fisher*, this case involves a situation where payment for transportation of property solely within the United States was made by a circuitous routing of checks through Canada. In the *Kellogg* case, all of the payments were by means of cashier's checks drawn on a United States bank and transported from the United States to Canada by an employee of the taxpayer where they were handed to an agent of the carrier. In *Fisher* the payments were made in three ways: by checks drawn on a United States bank, cashier's checks drawn on the same bank and bank drafts on a Canadian bank purchased by means of a debit to taxpayer's account in a United States bank. All of these instruments were then transported from the United States by an employee of the taxpayer to Canada where they were handed to an agent of the carrier. In this case, the taxpayer mailed the freight bills, together with the checks in payment thereof, to a Canadian affiliate. Then an employee of taxpayer traveled twice each week from Bellingham, Washington, to Vancouver, British Columbia, where he picked up the freight bills and checks and presented them to agents of the carriers in Vancouver. (R. 19-20.) Of the total amount of tax

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[3] To avoid unnecessary repetition and printing expense copies of the Government's brief in this Court in *Fisher Flouring Mills* v. *United States* are being served simultaneously with this brief upon this taxpayer's counsel and the arguments contained in that brief are here incorporated by reference.

paid, $28,027.84, checks drawn on accounts in United States banks totaled $6,258.21 and checks drawn on a Canadian bank account totaled $21,769.63. (R. 21-22.) It has been stipulated that the taxpayer's only purpose in following this procedure and in opening a bank account in Canada was to save transportation taxes. (R. 20, 21.)

As in *Kellogg* and *Fisher*, all of the property in question was shipped from one point in the United States to another point in the United States. The taxpayer, an Oregon corporation, has its principal place of business in Los Angeles, California. (R. 18-19.) The carriers, all located in the United States, sent their freight bills to the taxpayer in the United States. And still within the United States, checks were drawn in payment of the freight charges. (R. 19.) Next, all the checks were deposited by the carriers in banks located in the United States. (R. 22.) The mere fact of mailing the checks to Canada and there delivering them to agents of the carriers does not, it is submitted, make these amounts fall outside the statutory language, "paid within the United States" as set forth by Section 3475(a) of the Internal Revenue Code of 1939. Our argument in *Fisher* more fully develops our position that such amounts were indeed "paid within the United States" as those words are understood in their plain and ordinary meaning. The fact that some of these checks were drawn on a Canadian bank in no way tends to change the substance of these transactions as set forth above. Checks drawn in the United States on a foreign bank, coupled with the other factors here present, consti-

tute payments made within the United States. The location of the drawee bank relates merely to the payment of the check, and not to the payment of the underlying debt. From the facts it is clear that payment of the freight charges took place within the United States.

CONCLUSION

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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MAY, 1958

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No. 15,869

In the United States Court of Appeals for the Ninth Circuit

ALBERS MILLING COMPANY, A Corporation,
APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

MEMORANDUM FOR THE APPELLEE ON APPELLANT'S PETITION FOR REHEARING

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In the United States Court of Appeals for the Ninth Circuit

No. 15,869

ALBERS MILLING COMPANY, A Corporation,
APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

---

MEMORANDUM FOR THE APPELLEE ON APPELLANT'S PETITION FOR REHEARING

To the Honorable Albert Lee Stephens, Chief Judge, Homer T. Bone and Walter L. Pope, Judges of the United States Court of Appeals for the Ninth Circuit:

Appellee, the United States, is in receipt of a copy of a petition for rehearing which appellant states that it proposes to print and file in this case, and in which appellant requests that the rehearing be

held *en banc*. Although we respectfully submit that for the reasons set forth by this Court in its opinion in the instant case, by the Court of Claims in *Kellogg Co.* v. *United States*, 133 F. Supp. 387, certiorari denied, 350 U.S. 905, and by the United States in its briefs filed in this Court in this case and in *Fisher Flouring Mills Co.* v. *United States* (No. 15,819), the decisions of the Courts in this case and in the *Kellogg* case are correct, and although it is submitted further that appellant in the instant case is liable for the transportation taxes in issue, we do not in the public interest oppose the granting of appellant's petition for rehearing *en banc* for the reasons below stated:

1. This Court on September 10, 1958, rendered its opinion and judgment in this case affirming in favor of the United States as appellee a judgment of the United States District Court for the Southern District of California, Central Division.

2. On October 6, 1958, this Court as constituted by Judges Healy, Fee and Hamlin, rendered its opinion and judgment in *Fisher Flouring Mills Co.* v. *United States of America* (No. 15,819) reversing in favor of appellant the judgment of the United States District Court for the Western District of Washington, Northern Division. Prior to the hearings in the *Albers* and *Fisher* cases the United States requested the Clerk of this Court to set both cases for hearing together on the same day but this was not done, apparently because the cases arose in different districts.

3. Both of these cases present an identical question, namely whether taxpayer was not required by Section 3475(a) of the Internal Revenue Code of 1939 (as added by Section 620(a), Revenue Act of 1942, c. 619, 56 Stat. 798) to pay transportation taxes on shipments of property which were made entirely within the United States by carriers within the United States, solely because the freight charges were purportedly paid by checks and bank drafts manually delivered to offices of the carriers located outside the United States and where the sole purpose of this method of payment was to avoid the transportation tax.

4. On or before November 5, 1958, the United States will file with this Court its petition addressed to Judges Healy, Fee and Hamlin, requesting a rehearing *en banc* in the *Fisher* case. A copy of this petition, which is presently being printed, is contained in the appendix to this memorandum and made a part hereof. With all respect it is our view that the *Fisher* case was incorrectly decided.

5. Additionally, there is presently pending before this Court the same issue in an appeal by taxpayer from a judgment of the United States District Court for the Western District of Washington, Northern District, rendered September 16, 1957, in *Pacific Gamble Robinson Co.* v. *United States* (No. 15,818). The record and appellant's brief in this case have been printed and filed and a stipulation has been filed and approved providing that time for filing briefs is extended to thirty days after the final decision by this

Court in the instant case and in the *Fisher Flouring Mills Co.* case.

6. Because two panels of this Court have reached opposite conclusions on the same issue, and because a third case on this issue is presently pending before this Court, it is the view of the United States that the petitions for rehearing *en banc* in the case at bar and in *Fisher Flouring Mills Co.* should be granted. It is respectfully submitted it is in the public interest that the law be the same and settled throughout the circuit and that all taxpayers should be treated identically in every part of the circuit.

Accordingly, for the reasons above stated the United States submits that in the public interest petitions for rehearing *en banc* filed in this case and in the *Fisher* case should be granted.

Dated: Washington, D. C.

November , 1958

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 15,819

FISHER FLOURING MILLS COMPANY, A Corporation,
APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE
UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

PETITION BY THE APPELLEE
FOR REHEARING

TO THE HONORABLE WILLIAM HEALY, JAMES ALGER FEE AND OLIVER D. HAMLIN, JUDGES OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

Appellee hereby respectfully petitions for a rehearing of the above-entitled cause by the Court *en banc* for the following reasons:

1. On October 6, 1958, the Court as constituted by Your Honors rendered its opinion and judgment re-

versing in favor of appellant the judgment of the United States District Court for the Western District of Washington, Northern Division, in this case.

2. On September 10, 1958, this Court as constituted by Chief Judge Stephens and Judges Bone and Pope, rendered its opinion and judgment in *Albers Milling Company* v. *United States* (No. 15,869) affirming in favor of the United States as appellee a judgment of the United States District Court for the Southern District of California, Central Division.

3. Additionally, there is presently pending before this Court an appeal by taxpayer from a judgment of the United States District Court for the Western District of Washington, Northern Division, rendered September 16, 1957, in a cause entitled *Pacific Gamble Robinson Co.* v. *United States* (No. 15,818). The record and appellant's brief in this case have been printed and filed and a stipulation has been filed and approved providing that time for filing briefs is extended to thirty (30) days after the final decision by this Court in the instant case and in the *Albers Milling Co.* case.

4. The question presented in each of these three cases is identical, namely, whether taxpayer was not required by Section 3475(a) of the Internal Revenue Code of 1939 (as added by Section 620(a), Revenue Act of 1942, c. 619, 56 Stat. 798) to pay transportation taxes on shipments of property which were made entirely within the United States by carriers within the United States, solely because the freight charges were purportedly paid by checks and bank drafts manually delivered to offices of the carriers located outside the United States, and where the sole purpose of this method of payment was to avoid the transportation tax.

5. Two panels of this Court have reached opposite conclusions on the same issue and a third case is pending before this Court undecided raising the same issue. Prior to the hearings in the *Albers* and *Fisher* cases the United States requested the Clerk of this Court to set both cases for hearing together on the same day but this was not done, apparently because the cases arose in different districts.

6. Taxpayer in the *Albers* case has been granted thirty (30) days extended time in which to file its petition for rehearing thereby extending its time to November 10, 1958. We are informed that it is the intention of taxpayer *Albers Milling Co.* to file a timely petition in its case for rehearing by this Court *en banc*. Moreover, it is the intention of the United States as appellee in the *Albers Milling Co.* case, upon being informed that taxpayer there has filed its petition for rehearing, to inform the Court as constituted in the *Albers Milling Co.* case that the United States is of the view that in the public interest both cases should be reheard by the Court *en banc*.

7. The total amount of taxes involved in the three cases pending before this Court aggregate more than $153,000 without taking into consideration interest which will to date exceed fifty percent. The United States respectfully submits that it is in the public interest that the law be the same and settled throughout the circuit and that all taxpayers should be treated identically in every part of the circuit.

8. The question presented is one of importance and is pending in other cases and has been decided by the United States Court of Claims in *Kellogg Co.* v. *United States*, 133 F. Supp. 387, certiorari denied, 350 U.S. 903, in favor of the United States. We respectfully submit that for the reasons set forth by this Court in its decision in *Albers Milling Co.* v.

United States and by the Court of Claims in the *Kellogg Co.* case, and by the United States in its briefs filed in the *Albers Milling Co.* case and in the instant case, that the decisions of the Courts in *Albers Milling Co.* and *Kellogg Co.* are correct, and it is further respectfully submitted that the appellant in the instant case is liable for the transportation taxes in question and that the judgment of the District Court should be affirmed.

Accordingly, for all of the reasons above stated the United States earnestly petitions that in the public interest the Court grant a rehearing *en banc* in the above entitled case.

Dated: Washington, D. C., October 29, 1958.

Respectfully submitted.

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United States Attorney.

CERTIFICATE OF COUNSEL

I, CHARLES K. RICE, one of the attorneys for the appellee, certify that this petition is presented in good faith, that it is not interposed for delay, and that in my judgment it is well founded.

Dated: Washington, D. C., October 29, 1958.

CHARLES K. RICE,
Assistant Attorney General

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No. 15869

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERS MILLING COMPANY, a corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLANT'S PETITION FOR REHEARING.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERS MILLING COMPANY, a corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLANT'S PETITION FOR REHEARING.

To the Honorable Albert Lee Stephens, Homer T. Bone and Walter L. Pope, United States Court of Appeals for the Ninth Circuit, San Francisco, California:

Appellant, Albers Milling Company, hereby respectfully petitions for a rehearing in the above-entitled action, and urges the following in support thereof:

I.

Preliminary Statement.

(a) This petition is presented under Rule 23 of this Court and is filed at this time pursuant to a thirty-day extension granted by the Court on October 10, 1958.

(b) On October 6, 1958, the opinion of the United States Court of Appeals for the Ninth Circuit, before

the Honorable James Alger Fee, William Healy, and Oliver D. Hamlin, Jr., was filed in *Fisher Flouring Mills Company v. United States of America,* No. 15819. In the *Fisher* case the Court reversed the United States District Court for the Western District of Washington, Northern Division, to allow refund of the federal transporation taxes in question under facts virtually identical to those involved in the instant case. The Court in these two cases appears to have arrived at diametrically opposite interpretations of Section 3475(a) of the Internal Revenue Code of 1939, as amended, as applied to the given fact situation. Appellant firmly believes that a rehearing should be granted for the reasons hereinafter set forth and respectfully asks that the same be held *en banc.*

II.

In the Interests of Justice to Taxpayers and Government Alike It Is Essential That the Federal Tax Statutes Be Interpreted Uniformly Throughout a Given Circuit.

The possibility of divergent interpretations of a given tax statute between the Courts of Appeals for the various Circuits is a circumstance of which the Court has knowledge. If within each Circuit further differences of interpretation on identical points of law are to arise the problems of the taxpayer in determining his correct share of the tax, and the problems of the Government in collecting the tax and administering the tax laws will become even more cumbersome and perplexing than they now are.

III.

Appellant Urges That the Opinion of the Court Filed September 10, 1958, Be Reconsidered on the Merits, That the Same Be Vacated, and That the Judgment of the District Court Be Reversed.

Appellant respectfully urges further that a rehearing should be granted in order to reconsider on the merits the opinion entered herein, in view of the *Fisher Flouring Mills v. United States* opinion. The opinion in this action and the one in the *Fisher* case each recognize that the interpretation of the statutory phrase "paid within the United States" in Section 3475(a) of the Internal Revenue Code of 1939, as in effect during the period in question, is the fundamental point at issue. In the *Albers* opinion this Court has reasoned that Congress could not have intended this language to be interpreted literally since that would permit avoidance of the tax by all who elected to pay the freight bills outside the United States and would, in effect, nullify the statute. (Opinion, p. 3.) In the *Fisher* case, on the other hand, the Court concluded that the language used by Congress was so clear and so explicit that the tax should apply only where payment was made within the United States and that it was bound to accept this language even though by so doing some tax revenues would be lost to the Government. (*Fisher Flouring Mills v. United States of America,* opinion, pp. 2, 4, 5.)

A long line of substantial authorities has established the proposition that where a statute is clear on its face, and without conflicting internal provisions, the Courts will not resort to external aids for interpretation nor speculate as to what Congress would have intended under various fact situations. The fact that a taxpayer may have secured a tax benefit by conducting his business in

a particular manner under the statute was deemed immaterial. (See cases cited in Appellant's Br. pp. 12-15 and in *Fisher Flouring Mills v. United States of America,* opinion, pp. 5-7, and Footnote 7, including *United States v. Isham,* 17 Wall. 496, 21 L. Ed. 728; *United States v. Leslie Salt Company,* 218 F. 2d 91, affd. 350 U. S. 383, 100 L. Ed. 441; *Crooks v. Harelson,* 282 U. S. 55, 75 L. Ed. 156; *Lewyt Corporation v. Commissioner of Internal Revenue,* 349 U. S. 237, 99 L. Ed. 1029; *Addison v. Holly Hill Fruit Products,* 322 U. S. 607, 88 L. Ed. 1488; *Van Camp & Sons Company v. American Can Company,* 278 U. S. 245, 73 L. Ed. 311; *Gorin v. United States,* 111 F. 2d 712 (C. A. 9).)

In *Lewyt Corporation v. Commissioner of Internal Revenue, supra,* at page 240 the Court said:

> "But the rule that general equitable considerations do not control the measure of deductions or tax benefits cuts both ways. It is as applicable to the Government as to the Taxpayer. Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the Taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the Taxpayer though they represent an unexpected windfall."

In the *Albers* opinion the Court holds that the apparent intent of the statute to collect tax upon the transportation of property within the United States would have been nullified and the tax virtually eliminated if taxpayers were allowed to avoid the tax by paying the freight bills in Canada or in other places without the United States. The Court deemed it necessary, therefore, to interpret

the law to tax amounts paid without, as well as within, the United States.

Appellant respectfully urges that this is not a situation for the application of such a doctrine. Section 3475(a) is not ambiguous in itself and contains no inconsistent provisions, as such. The possibility of nullification, if such can be said to exist, comes only from the manner in which some taxpayers choose to conduct their business.

The tax laws are replete with situations where a person can avoid a tax by conducting himself or his business in a given manner. For example, an American citizen is not taxable upon income earned outside the United States while a foreign resident or, if not a resident, if he is present in the foreign countries during the prescribed period. (I. R. C., Sec. 911.) If a majority of American citizens should move abroad to avoid the tax, Congress would, no doubt, amend the law to tax income earned abroad, but until such an amendment is passed there is no question of the right of any individual to avoid the tax by establishing foreign residence or otherwise complying with the statutory provisions. In fact, the provisions permitting mere presence (as distinct from legal residence) abroad for the prescribed period to qualify were used by so many taxpayers to avoid the tax that Congress later amended the law to limit the exemption of earned income under Section 911(a)(2), Internal Revenue Code, to $20,000 per year. (Sec. 204(a), Technical Changes Act of 1953; Senate Report No. 685, 83rd Cong., 1st Sess.)

Thus Congress has always been alert where circumstances are considered to warrant it to prevent the "nullification" of a taxing statute by the action of individual taxpayers and has responded with specific legislation, in which specific effective dates are prescribed, to correct

the situation. Certainly this duty lies within Congress and not with the Courts.

Many other examples can be cited from the tax laws where taxpayer action could potentially nullify a particular tax, but the Courts have left it to Congress to correct such situations.

In *United States v. Leslie Salt Company,* 218 F. 2d 91 (C. A. 9, 1954), affd. 350 U. S. 383, 100 L. Ed. 441, this Court held that an instrument denominated a "promissory note" was not subject to stamp tax on issuance, since Congress had repealed the tax on "promissory notes" many years before. The Court acknowledged that if Congress had foreseen the development of corporate financing by means of large long-term bank placement loans like these it probably would not have repealed the tax on promissory notes but concluded that it was up to Congress to amend the law if it deemed such action necessary. This conclusion was reached even though the notes in question had many provisions like those of other types of obligation which were deemed taxable. (Appellant's Br. pp. 13-14.)

As pointed out in *United States v. Isham,* 17 Wall. 496, 21 L. Ed. 728, a person could avoid the stamp tax levied upon bank checks drawn in the amount of $20.00 or more by drawing a number of checks, each in an amount less than $20.00. The Court did not suggest that to allow such action would nullify the Stamp Tax Act, but noted that the taxpayer had a perfect right to do this to avoid the tax.

Appellant respectfully submits that the principles enunciated in the authorities cited on pages 3 and 4 of the opinion herein are not applicable to the case at bar. The pertinent provisions of the cited cases for the most part turn upon the interpretation of a statute which contained

within itself contradictory provisions. For example, in *Peck v. Jenness,* 7 How. 612, 12 L. Ed. 84, one section of the Bankruptcy Act stated that the Act should not impair any liens while another section provided for complete discharge of the debtor. The Court determined that the latter section was not intended to destroy the grant of the lien section, and held that the lien remained after the discharge in bankruptcy on the grounds that one part of a statute should not be interpreted to annul another part.

In *Hollander v. United States,* 248 F. 2d 247 (C. A. 2), a tax relief measure was in danger of becoming ineffective through operation of the statute of limitations. The Court refused to let the one provision thwart the other.

In the *Albers* case, however, the statute is plain upon its face. Section 3475(a) specifies the precise terms under which the tax is imposed. No other general provisions of the law conflict with Section 3475(a) to require a tax where under Section 3475(a) it would not be levied.

When Congress decided in 1950 that the law should be changed to tax payments made without, as well as within, the United States, it amended the law effective November 1, 1950. (Appellant's Br. pp. 6, 7.) The opinion herein has the effect of making this amendment retroactive where Congress itself did not do so. (Appellant's Br. p. 16.)

Furthermore, as stated in *Fisher Flouring Mills v. United States,* opinion page 2:

> ". . . where Congress has amended a statute to cover a 'loophole,' the fact that an addition has been required is proof that the prior statute should be given a different construction."

IV.

The Transportation Charges Were "Paid" in Canada.

Appellant respectfully urges that should the Court on rehearing determine that the tax does not apply where payment of the freight was made outside the United States, the payments here in question should be considered as made in Canada. In addition to the argument in Appellant's brief, pages 7-10, the Treasury Department release in Internal Revenue Bulletin 1958-33, August 18, 1958, page 27, issued after briefs were filed, is noted. In this release the question was presented whether transportation charges paid by mailing a check on July 31, 1958, were subject to the transportation tax which was repealed with respect to freight paid on or after August 1, 1958. The Treasury Department ruled in "Answer 2" of the Release that such a payment is subject to the tax since the payment took place when the check was mailed, which was before August 1, saying:

> "Where in the usual course of business a check in payment of the transportation charges is mailed to the carrier, the depositing of the check in the mail constitutes the payment of such charges."

By the same token, physically delivering a check to the agent of the carrier, as was done in this case, should be considered even more definitely consummation of the act of "payment." And this is particularly so with respect to the checks drawn upon and accepted by the drawee bank in Canada. (Appellant's Br. p. 9.)

V.

Conclusion.

Wherefore, Appellant prays that this Court's decision of September 10, 1958, be vacated, that a rehearing be granted *en banc* and, on rehearing, that the judgment of the Court below be reversed.

Respectfully submitted,

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Certificate of Counsel.

We hereby certify that in our judgment the Petition for Rehearing in *Albers Milling Company v. United States of America,* No. 15869, is well founded and that it is not interposed for delay.

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